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IMPROVING ENFORCEMENT OF TRADE AGREEMENTS

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

S. 490, S. 539 AND H.R. 3

MARCH 17, 1987

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IMPROVING ENFORCEMENT OF TRADE AGREEMENTS

TUESDAY, MARCH 17, 1987

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The committee met, pursuant to notice, at 10:01 a.m. in room SD-215, Dirksen Senate Office Building, the Honorable Lloyd Bentsen, Chairman, presiding.

Present: Senators Bentsen, Matsunaga, Baucus, Bradley, Pryor, Rockefeller, Daschle, Packwood, Roth, Danforth, Chafee, Heinz, Wallop, Durenberger, and Armstrong.

[The press release announcing the hearing and the prepared statement of Senator Moynihan follow:]

[Press Release H-27, March 6, 1987]

SENATE FINANCE COMMITTEE SCHEDULES HEARING ON PROVISIONS IN PENDING TRADE BILLS TO IMPROVE ENFORCEMENT OF TRADE AGREEMENTS

WASHINGTON, DC.—Senator Lloyd Bentsen (D., Texas), Chairman of the Senate Finance Committee, announced Friday that the Committee will hold a hearing to consider provisions on enforcing trade agreements in pending trade bills.

"Greater assurance of effective government action to enforce trade agreements is necessary," Senator Bentsen said. "What we need to do now is to carefully consider the aproaches in the major trade bills to determine the legislation that would best accomplish the basic objective on which there is consensus—trade agreements must be enforced," Bentsen said.

The hearing will center on sections 301 and 303 through 306 of S. 490, the Omnibus Trade Act of 1987; sections 111 through 118 of H.R. 3, the Trade and International Economic Policy Reform Act of 1987; and section 5007 of S. 539, the Trade, Employment, and Productivity Act of 1987.

The hearing is scheduled to begin at 10 a.m. on Tuesday, March 17, 1987, in room SD-215 of the Dirksen Senate Office Building.

Moynihan

STATEMENT BY DANIEL PATRICK MOYNIHAN
FINANCE COMMITTEE HEARING ON SECTION 301
March 17, 1987

Mr. Chairman, as the lead sponsor of the separate bill, S. 484, incorporating the proposals of the Omnibus Trade Act of 1987 to amend section 301 of the Trade Act of 1974, I would like to take this opportunity to reaffirm my support for substantially strengthening this area of our trade law.

Foreign trade barriers to exports of U.S. goods, services and investment present a serious problem for the Unites States. Japan is the nation most frequently cited for such practices, but other countries in the Far East and other areas of the world are also guilty of acts, policies and practices that constitute significant trade barriers.

For the second year, the office of the United States Trade Representative has issued a report of foreign trade barriers to U.S. exports. The 1986 report identifies barriers in 41 countries costing U.S. producers billions of dollars.

Our representatives have tried to remove these barriers to U.S. exports through negotiations, but too often to no avail. In part, this reflects the fact that foreign countries have little incentive to reduce their trade barriers because they believe correctly that the U.S. will do nothing in response. Ambassador Yeutter and Secretary Baker have previously testified before this Committee that the threat of retaliation is useful in making progress in negotiations. Yet as any parent -- or game theory specialist -- would attest, to be credible the threat must not be seen as empty. However, of the 58 section 301 cases initiated since the statute was enacted in 1974, there have been only seven instances of retaliation -- and these after protracted negotiations.

This has to change. We need to convince foreign countries that it is in their interest to eliminate their trade barriers and to do so promptly.

I believe that limiting those countries' access to our markets can provide the much needed leverage. We should require the President to use his existing authority under Section 301 of the Trade Act of 1974, as amended, to retaliate against countries that persist in maintaining trade barriers -- particularly when they have agreed to do otherwise.

I note that I sponsored S. 484, as I offered legislation in July 1985, in part as an alternative to those who would restrict imports from foreign countries with which the U.S. runs large trade deficits without regard to the extent to which those countries' trade barriers contribute to the deficits.

The message of those bills is "enough is enough, from now on you can't send us any more than we send you" -- even if those deficits largely reflect such factors as relative competitiveness, economic growth, fiscal and monetary policies, savings behavior, or exchange rates rather than trade barriers.

Thus, I am pleased by the recent proposal of the distinguished Co-Chairmen of the House Ways and Means Committee and its Trade Subcommittee, adopted by the Subcommittee on Trade last week, to moderate the "excessive" surpluses provision of omnibus trade legislation in the House. No longer would "excessive" surplus countries have to reduce their surplus with the U.S. by 10 percent a year to continue their access to U.S. markets. Instead, the proposal would require retaliation against the unfair trade practices of such countries, unless retaliation would harm the national economic interest. (Let us not forget that as the world's largest debtor nation -- $107 billion at year end 1985 and unofficially estimated to be close to $250 billion at the end of 1986 -- the United States will have to register large trade surpluses itself in the future).

S. 484 would focus on eliminating specific unfair trade practices as follows:

The President would be required to use his authority - under Section 301 of the Trade Act of 1974, as amended - to impose retaliatory import restrictions against foreign trade practices that: (1) violate the international legal rights of the United States ("unjustifiable"); and (2) are unfair and inequitable ("unreasonable") or place US companies at a disadvantage ("discriminatory").

The President would be required to retaliate within 15 months of the initiation of an investigation or within 9 months of a favorable GATT ruling. The deadline could be extended by the President for two 60 day periods if he certified to Congress that resolution of the dispute appeared imminent.

Retaliation against an unjustifiable practice would not be required if: (1) the GATT finds the practice is not unjustifiable; or (2) a settlement is reached that offsets or eliminates the unfair foreign practice. In addition, retaliation against an unreasonable or discriminatory practice would not be required if the President certifies to Congress that satisfactory resolution of the dispute appears impossible and that retaliation would harm "the national economic interest."

The President would be authorized to terminate or modify the retaliation -- and, if necessary, provide compensation -- if the GATT subsequently finds the retaliation to have been a violation of U.S. obligations or the industry agrees that the foreign practice has been eliminated or reduced.

The United States Trade Representative would be required to estimate the value of additional U.S. goods and services that would be exported if each unfair trade practice identified in the annual survey (National Trade Estimates) was eliminated. He would be required to initiate cases: (1) against all foreign trade practices that are "unjustifiable" and constitute a "significant" barrier to, or distortion of, U.S. trade; and (2) against those "unreasonable" foreign trade practices the elimination of which would create the greatest expansion in U.S. exports.

The President would be required to initiate negotiations with those countries USTR identifies as showing a consistent pattern of market distorting trade practices -- including, but not limited to, Japan. The President would be required to report to Congress by December 31, 1988, on agreements reached in eliminating the foreign practices and evidence of an increase in U.S. exports commensurate with the elimination of the barriers. In the event agreements are reached, commitments made, and then not lived up to, the mandatory retaliation provisions of section 301 would then be applicable.

Actionable unfair trade practices would be expanded to include: practices which displace U.S. exports to third markets or cause diversion of a third country's exports to the US; "targeting" industries for special development and advancement to the detriment of US commerce; trading by a state-owned enterprise on other than commercial considerations; foreign government requirements that US firms make some special concessions - such as licensing technology or building a foreign plant - in order to be permitted to export to that country.

Retaliation would end after 7 years, unless the industry seeking access to the foreign market requested its continuation. In that case, since the retaliatory import restrictions had burdened consumers but had not convinced the foreign country to eliminate its unfair trade practice, USTR could substitute a different retaliatory measure to increase pressure on the foreign country.

In sum, S. 484 would build on existing law by requiring the President to take action in order to obtain the leverage necessary to eliminate foreign trade barriers, while blunting pressure to restrict imports without justification.

Finally, I would like to make the point that unfair foreign trade practices are only one reason for the poor U.S.

trade performance. Others include large U.S. budget deficits, relatively poor productivity, the appreciation of the dollar from 1980 to 1985, slower growth in other developed countries, and reduced purchases by indebted LDC countries.

But eliminating such practices are important for two reasons. First, they result in lost U.S. exports -- a problem I am sure our witnesses will address in some detail. Second, unless and until the American public has confidence that its government is taking regular, swift and tough action to eliminate such practices, it will not be willing to address the other causes of our trade deficit.

Section 301 reform will be -- must be -- an integral part of this year's trade legislation and I welcome the comments of our distinguished witnesses on this important subject.

The CHAIRMAN. These hearings will come to order.

This morning's hearings will start out on Section 301.

The United States just has to make it clear that we are not going to tolerate unfair trade practices. Foreign countries know that the President has the power under Section 301, but they are not yet convinced that he will use it. Under Section 301 the President not only has broad power, but he also has very wide discretion. The purpose of the discretion is to allow the President to respond precisely but firmly to unfair trade practices; however, presidents have all too frequently interpreted the wide discretion of Section 301 to mean that they can and should do nothing about unfair trade practices.

At the urging of many members of Congress, and particularly members of this committee, President Reagan began in 1985 to use Section 301 more vigorously than he had in the past. And I commend him for that. But for five years President Reagan, like presidents before him, did not self-initiate Section 301 cases. Now, we just can't afford to repeat the first five years of the Reagan Administration's Section 301 policy when we have a new administration installed in office in 1989.

Using retaliation and the threat of retaliation to open foreign markets is an essential part of our trade policy. In proposing changes to Section 301, we want to leave the President free to take action that fits the offense, but we want to limit severely the discretion to take no action at all.

We hear a number of people say today that all we really have to do to take care of the trade imbalance is to change the exchange rates—the dollar to the pound and the yen and the mark and the franc—or to get these other countries such as Europe and Japan and Canada to expand their economies and to grow faster.

We have a new report from the Library of Congress that says if Europe, Canada and Japan increase their GNP by 2 percent—and that is a lot—that you would really only cut the deficit in trade in this country by some $8 billion.

So, it is obvious that the thrust of this legislation must be to open up those markets to our products. If those countries have full access to our markets, then we should have full access to theirs.

Now, we have three panels of witnesses to hear this morning, so we are going to be a little crowded on time, and I will ask that they abide by the limitations on the time for presentation. We will take their remarks into the record in full, their printed statements.

The first witness is Mr. Alan Holmer, the General Counsel of the Office of U.S. Trade Representative.

Mr. Holmer, we are pleased to have you here again. And I would defer to my friend Senator Packwood for any comments he might have.

Senator PACKWOOD. I am frankly surprised, Mr. Chairman, that we don't have more members here today; I thought that with this particular witness before us and the ones to follow, I thought we would have a fair number.

The CHAIRMAN. We will.

Senator PACKWOOD. I listened with interest to what you said about mandatory retaliation. I know the sincerity with which you hold your views, and by and large the moderate tenor of the bill that you have introduced. I know the pressures that you are under to introduce a bill infinitely more immoderate than what you have put in.

What bothers me about mandatory retaliation is this: The fact that it is mandatory. We are not really giving the President any more power than he has now; we are simply saying, "In certain circumstances, Mr. President, you must use those powers. You must use them against our most friendly allies and our most obnoxious enemies with equality. You shall take nothing else into account but markets." And I sometimes wonder if that is the only responsibility that the President has, or whether there are additional—and I mean additional—factors that he should consider in deciding whether or not to retaliate against the actions of a particular country.

My mind is undecided on this. I wish there were some other way, some other action that we could bring, preferably within the GATT structure, if we can. Because, if we mandate some retaliation, it is going to be in clear violation of GATT—there is no question of that—and I hate for the United States to be the one that can be pointed to as the leader in deciding to make unilateral decisions on trade retaliation. And, when our fellow GATT members say, "But that violates the GATT," we'd say, "Oh, well, that was last year's treaty."

I admire everything that the Chairman is trying to do. I have deep regard for his integrity, and I like a great portion of his bill. I have misgivings about mandatory retaliation that has no threshhold of discretion.

The **CHAIRMAN**. Since that was made in direct response to my comments, I might add that the question of mandatory retaliation has very severe limitations on it, and there is a general ability to use discretion. Obviously you would not in many instances treat allies or those that are contrary in their objectives to ours alike. You would be able to treat them differently.

When we used the term "mandatory," we referred to a direct violation of a trade agreement. And if you have a direct violation of a trade agreement, then I think action should be taken.

But Senator Chafee, you had a comment?

Senator **CHAFEE**. Thank you, Mr. Chairman.

I suspect that this particular issue is going to be the single biggest stumbling block in our trade legislation—that is, how much of the President's discretion to take from him? I share the concern that you have voiced. At the same time, I remember clearly Ambassador Strauss who said that the President's actions should be mandatory but not compulsory. I thought that was an ingenious way of phrasing this whole business.

Also, my position is that I have misgivings about forcing the President to take any kind of action along these lines, whether it is the result of a unanimous vote of the ITC or whatever it might be. The President indeed has to take a multitude of factors into consideration that are way beyond the ones that we see or that are totally affected by trade.

Also, I think we have got to remember the statistics that have been cited to us, even though there are questions as to their accuracy. Of our $170 billion deficit in trade, about $10–20 billion is the result of what we might term "unfair trade practices." Now, where that figure came from, I don't know; but that is the figure that seems to be constantly cited around here, and indeed I think, Mr. Chairman, you might have mentioned it yourself at one time.

So, this whole trade matter goes far deeper than 301 actions and unfair trade practices. It has to do with a whole series of other factors. Of course, every witness who has testified here has said the greatest single factor in the trade deficit is the federal budget deficit. But beyond that there are a whole series of actions that we ought to take under the label of improving our "competitiveness."

Mr. Chairman, I would like to ask you a question, which is as follows: It is my understanding that the desire of the Majority Leader as conveyed to the Committee Chairman that the Trade Bill go forward not just with the bill that you have introduced however it is altered, but also with a series of what we might call competitiveness factors added to it as part of the Trade Bill. That is what I have heard; am I incorrect in that?

The CHAIRMAN. I don't think we see a final decision on that, Senator. But what we are envisioning at this point, and hopefully we can work it out, is that this becomes a vehicle for other things from other committees, if they want to introduce them as independent pieces of legislation but subject to our decision for acceptance that we take them on as sections of this bill. And in that instance, one would assume that, just as with some of the budget proposals, those would be handled by the members of that specific committee once they were brought to the floor and voted on separately at that time as parts of this piece of legislation.

Senator CHAFEE. Well, I feel very strongly that we try to address the whole business of competitiveness. For example, we should look at changes in the Foreign Corrupt Practices Act, changes in the Antitrust Laws, and changes in our Export Control laws. Section 301 and the trade bill are important but indeed I think those other things are also important in improving our trade balance and assisting our manufacturers in competing abroad successfully.

The CHAIRMAN. Well, that is going to be part of our problem—what to accept to be added to it and what not to. That is a mixed blessing, as you can see. You can imagine some of the things that they will try to tie into this piece of legislation once we get it to the floor.

Senator CHAFEE. Yes. Fine. Thank you, Mr. Chairman.

The CHAIRMAN. Are there any other comments? If you have them, please limit them as I stated earlier, because we have three panels of witnesses this morning.

Senator ROTH. I will be very brief, Mr. Chairman, but I do think it is worthwhile noting with respect to importance of trade negotiations and the issue of mandatory requirements on the President that agriculture, the American Farm Bureau Federation together with the Grange and the Soya Bean Association, the National Federation, the Association of Wheat Growers, the Cattlemen's Association, the Corn Growers Association, the Pork Producers, Soya Bean Processors, as well as the Rice Millers, have come out with what I think is a very positive statement on trade dated March 12, 1987. The one thing that I think is pertinent to what we are considering today is that they are coming out for a strong, assertive, positive trade policy.

They say, "We also feel a few actions should be carefully avoided in trade legislation. Among them are proposals to require retaliation against countries deemed to have excessive bilateral trade surpluses with the United States. Secondly, proposals to place undue limits on Presidential discretion to make decisions in Sections 201 and 301 cases."

I share their concern as well as the concerns expressed by Senator Packwood and others, and I think the position of this very important agricultural group is extremely interesting and helpful.

The CHAIRMAN. Senator Danforth, do you have any comments?

Well, let me further comment that Senator Moynihan, who has played a principal role in sponsorship on Section 301 of S. 490 has a long-standing commitment and will not be able to be here. I am not sure that that might not have something to do with the day it is, St. Patrick's Day. [Laughter.]

But he wants the witnesses to know that he will be examining their testimony with great interest, after St. Patrick's Day, and he has some testimony that we will put in the record.

If you would proceed, Mr. Holmer.

STATEMENT OF ALAN HOLMER, GENERAL COUNSEL, OFFICE OF THE U.S. TRADE REPRESENTATIVE, WASHINGTON, DC, ACCOMPANIED BY JUDITH HIPPLER BELLO, DEPUTY GENERAL COUNSEL, AND CHAIRMAN, SECTION 301 COMMITTEE

Mr. HOLMER. Thank you very much, Mr. Chairman.

I am accompanied this morning by Judy Bello, who is my deputy and also serves as Chairman of the Interagency Section 301 Committee.

I can remember sitting in this hearing room in June 1985 during Ambassador Yeutter's confirmation hearing, listening to Senator Danforth, who was chairing that hearing, admonish Mr. Yeutter that one of his foremost priorities as USTR had to be to invigorate the Section 301 Program. I would like to think we have done that. The record is replete with first-time-ever actions taken by any President. The President has self-initiated actions under Section 301, he has retaliated, sometimes without even an investigation, he has publicly and privately threatened retaliation not once but many times, thus establishing without any doubt the credibility of the Section 301 Program; he has self-initiated cases under Section 307 against export performance requirements, a case where we got a deal acceptable to the U.S. industry in four months; he has creatively used Section 301 in conjunction with the dumping law, in the Japanese semiconductor case, and between 301 and the countervailing duty law in the Canadian lumber case. It is clearly the most aggressive program that has ever been undertaken by any President. And I think it has been successful in large part because of the flexibility with which we have been able to use Section 301.

We have also responded to congressional concerns in another area—namely, that the Administration work with the Congress on trade legislation, and that we submit our own bill. Well, we have done that—all 1600 pages of it—and we look forward to working with you and with members of your staff in crafting a bipartisan piece of legislation that the President can sign.

Included in our bill are three amendments to Section 301 which I can describe in the question and answer period, if you would like. But what I would like to do is turn, Mr. Chairman, to the issue that has been raised by each of the members that have spoken thus far, and it is the question of mandatory retaliation.

In considering any amendment to Section 301, I hope that you will ask one key question: Will this amendment help or hurt the ability of U.S. negotiators to pry open a foreign market to U.S. exports? It really comes down to this issue: Is Section 301 an import-relief law, or is it a negotiating tool? If you believe, as I do, that it is a negotiating tool, I would implore you to avoid mandatory retaliation.

Retaliation really means failure. It may make us feel better temporarily. It may provide import relief for another U.S. industry. But the guy that brought the case, the U.S. industry that brought the case, is generally not going to sell a nickel's more goods in that foreign market simply because we have retaliated. In fact, their sales may go down because of subtle or sometimes not so subtle counter-retaliation.

What you have to have is a credible threat of retaliation. And I submit that the record of this Administration over the last 20 months makes it quite clear that we are very willing to exercise that threat.

If you say "mandatory retaliation" up front, basically it is not a negotiation. If you stick a retaliation gun to the head of your trading partner, if you do it for the Europeans or the Brazilians or the Canadians or others, you are going to create a public, nationalistic backlash that is likely to reduce their negotiating flexibility.

It seems to me that it is imperative, as we try to write the 1987 Trade Bill, that we do it with an eye toward the future. The United States is not always going to have a $170 billion trade deficit; in fact, if you believe the economists, we are going to have to have a substantial trade surplus in the 1990's to be able to finance our substantial foreign debt. I can imagine how I would feel if a foreign government official from Country-X came into our offices at the USTR, stuck a retaliation gun to our head, and said, "We're tired of the U.S. trade practices that we, unilaterally in Country-X, have decided are unfair. We want you to get rid of your steel quotas, your textile quotas, your quotas on sugar and meat and dairy products and peanuts and cotton and sugar-containing products and machine tools, we want you to get rid of your Buy-America provisions and your agricultural export subsidies and your price support programs and your Superfund taxes and your custom user fees. We don't like the way you administer the dumping and countervailing duty law; we believe that is unjustifiable. You've got to change those practices. Get rid of your fishing laws, get rid of Section 337, certainly get rid of your extraterritorial technology controls, get rid of the semiconductor third country dumping agreement, do it all in 15 months—do it in six months if you enact the Gephardt amendment—do it in the glare of the public spotlight, and if you don't, on all of those things we are going to whack you."

My point, Mr. Chairman and members of the Committee, is not to justify foreign trade practices by highlighting ours. My point is that trade distorting practices are in place in the U.S. and elsewhere in the world because of powerful domestic political pressures, and it is impossible even for the United States Trade Representative, with all of the powers that you propose to give him, or even for the powerful Senate Finance Committee, to wave these practices away with a magic wand that we call Section 301.

Finally, Mr. Chairman, retaliation is not cost-free. We retaliated against the Europeans in the citrus case. They hit us back on walnuts and lemons. We announced retaliation in the EC enlargement case. They threatened counter-retaliation on corn gluten feed. Legislatively, it seems to me you need to give us the tools which we already (for the most part) have under Section 301, and then use your political leverage to make sure that this Administration and future administrations act. I believe that that approach has been extraordinarily successful over the last 20 months, as I indicated, the most aggressive program under 301 that we have had in history.

Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Holmer, I really thank you for that straw man. When I look at the situation such as you have described, we are talking about making action mandatory when you have a violation of a trade agreement. When you say it might hurt negotiations—what we are trying to have is a deterrent put up ahead of time so they know what their problem is going to be if they violate those trade agreements. And then we say that it is not going to be some minimal amount; we say that it has to be a major amount of trade involved.

When is it in the national interest to have one of these countries violate trade agreements that we have with them?

Mr. HOLMER. I can't think of many times where it is in the U.S. interests to have them violate a trade agreement. But the question is: Is mandatory retaliation going to be the most appropriate mechanism in order to make sure that you get rid of that unjustifiable trade practice? Of which we have many ourselves.

The CHAIRMAN. Not an "undesirable trade practice" but a violation of a trade agreement with this country. That is what we are talking about. You have various shades of undesirable trade practices, so let us not put that one out there. What we are talking about is the direct violation of a trade agreement with this country. That is when we are talking about it being mandatory, and that it not be a minimal deal, that we are talking about a substantial amount of trade involved.

Now, it is quite true that you have done a great number of ad hoc things over the last year, and you have made them understand that if they continue to do these things they are going to pay a price for it. I commend you for what you did when Spain and Portugal went into the Common Market; but I look back to the time when Greece did, and nothing was done.

Now, if something had been consistently done and they knew that was what was going to be the reaction of the United States, I dare prophesize that you wouldn't have nearly as many of those kinds of violations.

Mr. **Holmer**. Mr. Chairman, I would respectfully disagree with that, and I think the EC case on enlargement is a good example.

We set a deadline of July 1 for that case, and if we had been required to retaliate on July 1, as opposed to the case being able to spill over for a day or two and allowing Ambassador Yeutter and his counterpart Mr. DeClerc to be able to have a Transatlantic plane ride where they were able to reach a settlement in that case, you might have had a cycle of retaliation and counter retaliation making it impossible to get that case resolved. They were able to declare a cease-fire on July 1, and they set another deadline of December 31.

Well, you had a problem with respect to the French; you had a problem with respect to the Christmas holidays; you had a situation where we were close to getting an agreement, but we needed about a 30-day period to get an acceptable resolution of that case.

The only concern that we have is that, if you so prescribe legislatively what the hoops are that any USTR is going to have to jump through, or any President is going to have to jump through, you are bound to have a case that we are not smart enough to think of right now, where you get down to the deadline, where we have to retaliate, and the result is that you have a public, nationalistic backlash that reduces our opposite number from being able to have that kind of flexibility.

The **Chairman**. Mr. Holmer, our time is running out. You have 15 months. That takes care of the French holidays, that takes care of August in Europe. You have two 60-day extensions. And one of the things I have learned in negotiations is, if you do have a deadline, people finally get together at the last.

I saw Ambassador Yeutter go down to Punta del Este and give them a deadline. He told them you were going to walk, that you were heading back to the United States if they didn't meet that deadline, and what did they do? Stayed up all night and they finally met it. So, having deadlines can be extremely helpful to negotiators. And if you have a pattern of having responded and doing it consistently, then they usually don't try that sort of action on you in the future; you have it as a very major deterrent.

Now, the list of arrivals is: Senators Packwood, Chafee, Danforth, Pryor, Armstrong, Baucus.

Senator Packwood.

Senator **Packwood**. Mr. Holmer, the Chairman puts the problem in a nutshell. I think he is saying that the threat of mandatory retaliation will prevent its ever having to be used, or having to be used one time in 20, with the other 19 countries absolutely caving in for fear of losing access to the markets. It may work that way, it may not—we don't know.

Let me ask you a specific question, because the Chairman correctly says in his bill that mandatory retaliation only exists if it is a violation of a trade agreement, and normally those are GATT trade agreements. Is there a method of handling such disputes in the GATT?

Mr. **Holmer**. Yes, there is.

Senator **Packwood**. For trade violations?

Mr. **Holmer**. Yes, there is.

Senator PACKWOOD. And if we were going to pass a law that says, regardless of that and regardless of the fact that we have agreed to it, we are going to unilaterally determine when there are trade violations and require retaliation within 15 months, would that violate the GATT?

Mr. HOLMER. Yes, it would, Senator Packwood.

Senator PACKWOOD. It surely would, because we have agreed to use the GATT as a method of resolution for those topics that the GATT covers.

Interestingly, under the Chairman's bill, for those things that are not trade violations, there is no mandatory retaliation. So the very thing that we have agreed with GATT to do, we are going to say, "But we decided we are not going to do it." Alright, enough said on that.

Why did the USTR decide not to initiate the case filed recently by the Rice Millers Association? Here is an example of an organization that came in wanting action; the Administration waited, weighed the pros and cons and decided not to.

Mr. HOLMER. We did. The point of section 301 is to get market access. In that case, there were very polarized views in Japan with respect to rice; it goes back to their experience following World War II and maybe even before.

If we had brought the case, the Japanese would not have opened up their market within the timeframe set, they would have refused compensation in other areas, and in the end we would have been forced to retaliate against their exports to the U.S.—a market-closing response that would have gotten nothing for the rice millers.

Ambassador Yeutter's judgment was that, if he was able to pursue that in the Uruguay Round and do it on a relatively fast-track basis, and establish a deadline of July 1 of this year when we are going to review the situation, that was going to be a far more favorable approach toward getting a market-opening response as opposed to accepting the 301 case which would have resulted in a market-closing response.

Senator PACKWOOD. Well, in this case you are not really balancing trade or economic reasons with defense reasons; you are just saying from a trade standpoint, in your judgment, the best action was not to take action.

Mr. HOLMER. Exactly. We want to open up that market, and we felt accepting the case was going to be counterproductive to that goal.

Senator PACKWOOD. I notice on our witness list today that five out of the six on the next panel will be complaining about actions by Japan. Is Japan your worst problem?

Mr. HOLMER. Ambassador Yeutter, when he was here last February, indicated that he was relatively satisfied with most of our bilateral trade relationships, but there was particular difficulty with respect to Japan.

Senator PACKWOOD. What success have you had in the sectoral bargaining with Japan?

Mr. HOLMER. Clearly, exchange rates. Semiconductors if they live up to their agreement.

Senator PACKWOOD. You are still giving them to the end of this month, right?

Mr. **Holmer**. On one part of it, and until the end of last month with respect to the third-country dumping part of it.

Senator **Packwood**. Excuse me. What happened? Did they quit dumping in the third countries?

Mr. **Holmer**. We are going to find out. The Commerce Department is in the process of doing a comprehensive review, and based on that review we will have a decision made soon at high levels. But you have that case and recently the lawyers case, the Japan tobacco case, the fish case, where we have a tentative agreement with the Japanese, the compensation they provided in the leather and leather footwear cases. We are reasonably satisfied on those, but there are still a lot of problems.

Senator **Packwood**. Let me ask you a last question. Are you familiar with Article 23 in the GATT?

Mr. **Holmer**. Yes, sir.

Senator **Packwood**. It is kind of a broad-based Article that might permit bringing a charge against a country practically for their collage or ambience of trade practices. You don't have to narrow in on something specific; you can simply say, "The entire tenor of your action in this country is violating GATT agreements." Is that roughly correct?

Mr. **Holmer**. Yes. You can bring an action if the activities of a foreign country essentially have nullified or impaired the benefits that would accrue to the United States under the GATT.

Senator **Packwood**. In the early 1980's the Europeans toyed with this idea, didn't they?

Mr. **Holmer**. Yes.

Senator **Packwood**. Instead of mandatory retaliation, what is wrong with the United States bringing an Article 23 action and asking our other trading partners around the world to join with us in a collective Article 23 action against Japan?

Mr. **Holmer**. That is a big undertaking, Senator.

Senator **Packwood**. Yes.

Mr. **Holmer**. There would obviously be those within the Administration—either at the State Department or at the National Security Council, or others—who would have some very strong views about it. I won't make their brief for them here.

The proposal is interesting in that one of the frustrations that we have had in responding to the proposals in S. 490 and those on the House side is that basically they take the frustrations that have boiled up over Japan, and applied that across the board with respect to everything. And in a sense, the proposal you are talking about is one that would really address the Japan trade issue head on.

Senator **Packwood**. It is aimed at Japan. It asks England, the rest of the Common Market, and perhaps other countries to join with us, all of whom have the same aggravations. We are not unique in our problems with Japan. And it is a collective world action aimed at Japan's action.

Mr. **Holmer**. Right.

The other problem with the proposals we have seen both here and on the House side, is that they require mandatory retaliation at the end of the day, and mandatory retaliation without GATT sanction is GATT-illegal. One of the attractions of the Article

XXIII proposal—without indicating any Administration support or opposition to it, but one of the reasons why there would be some interest in it, is that it does contemplate addressing this problem in a manner that follows the GATT rules and follows them in a GATT-legal way.

Senator PACKWOOD. Thank you very much.

The CHAIRMAN. I might comment just for a moment insofar as having an action taken here gives 15 months for GATT to make that decision. And if GATT decides—and that is under this bill, addressing the point that you were talking about—if GATT decides that that would be a violation of the GATT rules, the President doesn't have to do it; it is not mandatory under those conditions. And this specifically provides that, and gives the President an out in that kind of a situation.

Now Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman.

I would start off with the fact that nations just don't always behave in a rational manner. When we try to bully around other nations, even though the action that we are requiring them to take might indeed be in their economic best interests, they don't respond that way. Congress has had great experience with mandating actions, trying to force countries by ultimatums to do something. I remember the Turkish Arms Embargo. That went through. The requirement was that the Turks were to get out of Cyprus, and if they didn't, they weren't going to get any more arms from the United States. They didn't get out of Cyprus, and the whole policy was a disaster. Subsequently we reversed it by a vote of Congress.

So, I would urge my fellow members of this committee to remember some of those lessons. Nations don't behave rationally. Every little nation in the world wants to have an airline. It makes no sense whatsoever economically or in other ways; but still, they proceed, and have one.

Now, I would like to ask you, Mr. Holmer, a couple of questions: First, what do you think about the provision in the committee bill that provides that targeting becomes the basis for a 301 case. That seems to me to make considerable sense. What is the Administration's viewpoint?

Mr. HOLMER. I guess there are a couple of answers. First, we regard it as being unnecessary. We cite the Japanese semiconductor case or the Brazilian computer case as being examples, where clearly you had an industry that was targeted.

Senator CHAFEE. All right. Assume it is unnecessary, but it is in there. Now, what do you say?

Mr. HOLMER. We have some technical suggestions that we would like to work out with the staff, in terms of the laundry list of those items that would be actionable under the export targeting provision, and I am confident we can work those out.

The one thing we need to have our eyes open about is that we target, too. I indicate on page 8 of my testimony some of the examples of where U.S. industries might be vulnerable to mirror legislation that would be enacted by our trading partners.

Senator CHAFEE. Well, if we target, we are not very successful at it. Page 8?

Mr. Holmer. You have the wheat farmers and the rice farmers, our lumber exporters, and a number of others.

Senator **Chafee.** All right.

Now, my next question is: Making technology transfer the basis for a 301 case. That is a provision that I introduced as a bill in the last Congress. Senators Mitchell, Roth, and Bingaman were cosponsors, as I recall. This provision states that if a nation we sell to requires that we share our technology in order to do business in that market, that requirement can be the basis of a 301 case. What do you think of that one?

Mr. Holmer. I will let Mrs. Bello respond to that.

Mrs. Bello. Senator, again that is an unnecessary amendment, because we already have ample authority under Section 301 to find that such technology-inducement requirements are an unreasonable practice, and if they burden or restrict U.S. commerce, we can act against them.

We have indicated to committee staff that we have some problems of a technical nature with the drafting of these particular proposals. But in principle, we don't generally oppose them because in fact they are already actionable, and in fact, for example, we already persuaded the Government of Korea to eliminate the technology transfer controls and the requirements for joint supply ventures, or raw supply agreements as a basis for according protection to trademarks in Korea.

Senator **Chafee.** Let me ask you about a bill that Senator Danforth has introduced which I think has a lot of merit. It deals with telecommunications reciprocity. If Japan or the EC won't let us sell our telecommunications equipment in their markets, then we won't let them sell their telecommunications equipment in our market. Now, that is not in the legislation we are discussing today. That is a separate bill.

Mr. Holmer. Right. One concern we have with respect to telecommunications or other proposals like that—one, we are unenthusiastic about sector-specific bills. You have seen it in part on the House side, in the markup there. You open the door and——

Senator **Chafee.** Well, that is a separate bill.

Mr. Holmer. Understood.

Senator **Chafee.** It wouldn't be part of a trade bill overall.

Mr. Holmer. We need tools that will give us the flexibility which we have used aggressively in the last 20 months, and which you will continue to make sure that we use aggressively.

Our concern is that, if there are requirements with respect to specific negotiating objectives, where we have to state up-front what our bottom-line negotiating objectives are, or where you have mandatory retaliation at the end of the day, then we have difficulty with respect to telecommunications proposals.

Senator **Chafee.** Thank you.

Thank you, Mr. Chairman.

The **Chairman.** Senator Danforth.

Senator **Danforth.** Thank you, Mr. Chairman.

Mr. Holmer, first let me say that I absolutely agree with you, at least in one respect, and that is that the purpose of Section 301 is not to close our market but to open the markets of other countries.

Therefore, as you have well stated it, the issue is whether or not Section 301 is a credible threat. Correct?

Mr. **Holmer**. Yes.

Senator **Danforth**. Now, then, Section 301 has been on the books for 12-plus years, correct?

Mr. **Holmer**. Yes.

Senator **Danforth**. Can you tell me, in 12-plus years, how many times we have retaliated against an unfair trade practice under Section 301?

Mr. **Holmer**. Retaliated seven times, publicly threatened retaliation twice, privately threatened retaliation many more times.

Senator **Danforth**. Could you submit to the committee a list of all of the times in 12-plus years we have retaliated under Section 301?

Mr. **Holmer**. Yes, I will, although it will be very, very heavily weighted toward the last 20 months, when we have had this particularly aggressive use of Section 301.

Senator **Danforth**. Fine.

[The information follows:]

OFFICE OF THE UNITED STATES
TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON
20506

April 1, 1987

The Honorable Lloyd Bentsen
Chairman
Senate Finance Committee
United States Senate
Washington, D.C. 20510

Dear Chairman Bentsen:

During the Senate Finance Committee's March 17 hearing on Section 301, Senator Danforth asked for a list of all the Section 301 cases in which any President has retaliated. These cases are as follows:

- In the Canada Border Broadcasting case (docket 301-15), the President determined that the most appropriate response to Canada's unreasonable, discriminatory tax deductions was mirror legislation in the U.S. He forwarded proposed legislation to the Congress on September 9, 1980, and again in November 1981. The legislation requested was enacted on October 30, 1984, as part of the Trade and Tariff Act of 1984 (section 232).
- In the Argentina Hides case (docket 301-24), the President increased the U.S. tariff on leather imports effective October 30, 1982, in response to a breach by the Government of Argentina of a bilateral agreement on leather hides.
- In the EC Citrus case (docket 301-11), the President imposed substantially higher duties on pasta imported from the EC from November 1, 1985, until August 21, 1986, when the increased duties were withdrawn following the attainment of an acceptable solution in this case.
- In the Japan Leather (docket 301-13) and Japan Leather Footwear (docket 301-36) cases, in March 1986 the President increased duties on an estimated $24 million in imports of certain leather and leather goods from Japan, in addition to obtaining an estimated $236 million in compensation from Japan through reduced or bound Japanese tariffs.
- In the EC Enlargement case (docket 301-54), in May 1986 the President proclaimed quotas on imports of certain products from the EC (certain chocolate, candy, apple juice, certain beer and white wine) in response to EC quantitative restrictions

in Portugal on soybeans and feedgrains. These quotas are adjustable to mirror the effects of the EC measures on U.S. exports to Portugal, and to date have been maintained at non-restrictive levels. In addition, the President announced his determination to impose prohibitive tariffs (up to 200 percent) on other imports from the EC in response to EC tariff measures in Spain on corn and sorghum imports. The retaliation was not implemented only because the EC agreed to fully compensate the U.S. for these tariff measures.

- In connection with the U.S.-Canada Softwood Lumber Agreement (docket 301-58), effective December 30, 1986, the President established a temporary duty of 15 percent ad valorem on imports of certain Canadian softwood lumber products, pending collection by the Government of Canada of a 15 percent export tax on such product shipments to the United States.

Most recently, the President announced on March 27, 1987, his decision to retaliate against the Government of Japan for its failure to fulfill obligations under the U.S.-Japan Arrangement on Trade in Semiconductor Products. The retaliation is to take the form of prohibitive duties (up to 100 percent) on imports of various Japanese products totaling $300 million in value ($135 million for Japan's failure to meet its commitments regarding third country dumping, and $165 million for its failure to meet its commitments regarding access to its semiconductor market).

In addition, the President has determined to retaliate in some Section 301 cases, and later decided not to do so only because his action induced the foreign government concerned to agree to a satisfactory settlement. This occurred, for example, in the Taiwan Customs Valuation (docket 301-56) and Taiwan Beer, Wine and Tobacco (docket 301-57) cases.

Sincerely,

Alan F. Holmer

Alan F. Holmer
General Counsel

Senator Danforth. And how many times has Section 301 been used to retailiate against Japan?

Mr. Holmer. Two times as a part of the Japan leather and Japan leather footwear cases, and again I would be happy to indicate to you privately or to any members of the committee privately those instances where there has been a clear deadline that approached with respect to a 301 case, where the issue has gone to the President, and where a U.S. negotiator has come back and sat down across the table and said, "This is it, guys. We have got 48 hours."

Senator Danforth. My question isn't the verbiage that is used by our negotiators. My question is: How many times has Section 301 been used in 12-plus years?

Mr. Holmer. Well, the answer in terms of formal retaliation is twice; in terms of very credible threats of retaliation——

Senator Danforth. I am not interested in threats; I am interested in whether the whole system is credible. I would submit we have only counted three instances of retaliation in the history of Section 301, and only one against Japan; but I would like to look at your list.

Now, every year, by virtue of the 1984 Trade Act, the USTR prepares the National Trade Estimates, which is a listing of significant unfair trade practices; is that correct?

Mr. Holmer. Did you say unfair trade practices?

Senator Danforth. Unfair trade practices, right.

Mr. Holmer. Well, it is "significant trade barriers," both fair and unfair; for example, we list tariffs as being a trade barrier.

Senator Danforth. Significant trade barriers, fair and unfair.

Mr. Holmer. Right.

Senator Danforth. Would it be fair to say that a substantial number of the trade barriers that are listed in the National Trade Estimates could be called "unfair trade practices"?

Mr. Holmer. Yes.

Senator Danforth. And this year's most recent listing of unfair trade practices is in this book in my hand?

Mr. Holmer. That is correct.

Senator Danforth. This is just the current listing of trade barriers?

Mr. Holmer. Well, we have attempted to be overly inclusive. There are a number of those that an objective observer might regard as being not necessarily a significant barrier to U.S. exports; but we wanted to make sure that we covered the waterfront.

Senator Danforth. The listing for Japan, which you called the "number-one trade problem" or the Ambassador has called the number-one trade problem, the listing for Japan is 20 pages. It is reasonable to believe that there are at least 20 pages of unfair trade practices in these pages, correct?

Mr. Holmer. There are a whole bunch.

Senator Danforth. Do you think that Japan is quaking in its boots about retaliation under Section 301 by the United States?

Mr. Holmer. I think they have an entirely different view now than they had 20 months ago with respect of the willingness of the United States to retaliate, and I think over the course of the next few weeks and few months, as you see the semiconductor issue and the supercomputer issue and the Kansai Airport issue and others reach flashpoints, it will become all the more credible.

The CHAIRMAN. Senator Pryor.

Senator PRYOR. Thank you, Mr. Chairman.

Mr. Holmer, Senator Packwood a moment ago asked you about the 301 case brought by the Rice Millers. I think everyone in this town knows that that case, through this convoluted system that we have, ultimately rewarded the law breaker. I won't ask you to comment on that further.

Now, also we have been waiting 10 years in this process for a resolution of the citrus case—10 years.

The CHAIRMAN. Fourteen.

Senator PRYOR. Fourteen years.—the Chairman corrects me.

Even after the EC enlargement case was allegedly settled. Now the Europeans are attacking from a new angle, and that is a new tax on U.S. soybean oil.

The National Broiler Council of our country had to wait three years before it could get the three involved parties even to sit down at the negotiation table. After two years, a GATT dispute settlement panel approved a report in favor of the U.S. pasta producers and manufacturers; however, since May 19, 1983, the approval of that decision has been blocked by the Subsidies Code Committee of GATT. Almost 60 percent of all cases brought to the GATT concern complaints about agricultural trade. Since 1975, virtually all subsidy cases have concerned agricultural products. And I must say, Mr. Holmer, it is like throwing these cases into a black hole to try to get some resolution.

Now, you say three times io your statement and in answering questions, you say "We need tools, "we need tools." Well, I have got a proposal to give you some tools, and that is in the area of agricultural products. I would like your comment on it. I would like to propose in my legislation that we either refer agriculture-related 301 matters to the GATT, or give the USTR the option to bypass that unsatisfactory process and proceed immediately to bilateral negotiations. Now, that is a tool. That is a tool relative to agriculture products, and I am wondering if you would support granting that new tool at this time.

Mr. HOLMER. We can take a careful look at that, Senator Pryor.

Senator PRYOR. How long does a "careful look" take?

Mr. HOLMER. Well, we will certainly be ready at the time that the committee is ready to mark up the Omnibus Bill. My guess is that ultimately the Administration will have concerns about that proposal.

Senator PRYOR. What concerns will they have?

Mr. HOLMER. The concern is reflected in rationale for that provision being in the statute in the first place—that is, if you have a Section 301 case that involves a trade agreement, the USTR and the President should be required to take that issue to the appropriate GATT dispute settlement body. It makes sense that if you do have a problem under a trade agreement, that you ought to address it under that trade agreement's dispute settlement mechanism, as opposed to the United States going off on its own, declaring on its own what are or are not unfair trade practices, and retaliating on our own, and thus opening up the possibility that there might be counter-retaliation.

We have all of the concerns that you have with respect to the dispute settlement mechanism in the GATT. We are attempting to address that in the new round. I would submit, though, that the dispute settlement mechanism is not in quite the degree of disrepair that we might sometimes feel.

If you separate out the EC agriculture cases, which have been the biggest part of the problem, and look at all the other cases, from the time that a GATT panel is formed and the time that the GATT council approves the GATT panel's report, it takes on average ten and a half months. That compares, I think, quite favorably with the timeframe of any kind of civil litigation that you have in U.S. courts.

Senator PRYOR. You are against, then, putting this in the statute at this time, putting this in the law?

Mr. HOLMER. I indicated a willingness to take a look at it. I want to give you a foreshadowing as to what I anticipate is going to be some of the concerns of the Administration.

Senator PRYOR. With all due respect, when you come here before this committee and say, "We need tools," what are you asking for?

Mr. HOLMER. We need the tools principally that we already have in Section 301. Section 301 is a superb statute. It gives the U.S. Trade Representative virtually all the power that he needs, and the amendments that we have proposed are ones that for the most part alter Section 301 at the margins. We think that Section 301 fundamentally is sound and gives us all that we need, provided that you don't so handcuff your negotiators that they can't achieve the objective that you want them to achieve.

Senator PRYOR. I am glad my time ran out, Mr. Chairman. [Laughter.]

The CHAIRMAN. And it is tough for the Chairman not to answer each time.

Let me call on Senator Armstrong. And let me read the list again. It is Armstrong, Baucus, Durenberger, Daschle, Wallop, and Heinz.

Senator ARMSTRONG. Mr. Chairman, I think I can save you a few minutes. I don't really have any questions I wish to propound at this time, but I would observe, in passing, that I am increasingly frustrated with the course of the discussion about trade policy. I started out as a free trader, and yet everytime I run up against the USTR or the Administration, I get the impression that what they are really saying is, "Leave us alone; we know what we are doing, and we don't need your help, and we sure as thunder don't need any direction from the Congress." That may be a good approach to the problem, but instinctively it doesn't sit real well with me and, I judge, with other members of the committee. Maybe I misunderstand the attitude of the USTR and others in the Administration, but I don't think so.

Mr. HOLMER. If I could, Mr. Chairman? We want to work with Senator Armstrong and all the members of the committee, (1) in drafting legislation——

Senator ARMSTRONG. Mr. Holmer, I don't mean to give offense, but that is simply not borne out by past experience. You know, I'm glad to have that expression of interest, but it is not borne out by the past experience which I have had. If other members of the committee have had that experience, it has not been brought to my attention.

The CHAIRMAN. Senator Baucus.

Senator BAUCUS. Thank you, Mr. Chairman.

Mr. Holmer, frankly, I am a little surprised you are not up here demanding mandatory retaliation. You know, if the USTR is charged with protecting America's trade position, and certainly under Section 301 it is charged with opening up other countries to U.S. products—opening up their markets to U.S. products—it seems to me that the USTR would want to have as a strong tool, a strong club in its arsenal, mandatory retaliation. We all know that most people in the world want to raise their economic standards, their standard of living, as much as they can. They are going to try to sell to U.S. markets as best they can, and sometimes those efforts will be if not blatant unfair foreign trade practices, will certainly border on unfair foreign trade practices.

They will not, out of the goodness of their hearts, altruistically back off and be nice, good guys. That is just not human nature. So we have to have an effective policy that forces those countries to back off of unfair foreign trade practices, and Section 301 is a tool.

It also seems to me that in many cases your hand is strengthened if the statute says that there will be mandatory retaliation, say within 15 months.

I would think that the USTR and the Secretary of Commerce and others in the Administration would want to have mandatory retaliation as a back-up to force those other countries to back off. I would think that they would not want too much discretion, because often too much discretion clouds the issue. One can rationalize taking or not taking an action because, in a certain case, of too much discretion.

So why isn't the USTR up here saying, "We would like to have mandatory retaliation, so that during the 15 months we could encourage these other countries to back off?"

I get the feeling, frankly, that the USTR and the Administration is somewhat like the Japanese. The Japanese don't do anything until they are forced to do something. The Administration didn't really begin to aggressively utilize Section 301 until it perceived the threat that Congress will force it to do something. That is what forced the Administration to act, the threat of Congress passing legislation to force the Administration. The Administration is like the Japanese. You know, you just do enough to try to get us to not do what we would otherwise do.

So, why doesn't the Administration want this Congress to pass this bill—that is, mandatory retaliation—so that other countries know we mean business?

After all, let us remind ourselves, as Senator Danforth pointed out, this Administration has not been overreaching in its implementation of Section 301. This Administration and this country brings Section 301 action only in the most egregious cases—only in the most egregious. We don't overreach.

Since we do not have a history of overreaching, why would we not want to have in our arsenal mandatory retaliation?

Mr. HOLMER. We want retaliation to be in our arsenal. But the question is: Do you want in every single unjustifiable case—"unjustifiable" in quotes, as defined in the statute—do you want the requirement that in every case by a precise, set deadline, that the Section 301 program is on automatic pilot, you are not going to give your President——

Senator BAUCUS. I think most people in a situation where there is an unjustifiable, unfair foreign trade practice would want a deadline, a fixed deadline. Most common-sense folks in those circumstances would want a fixed deadline.

Mr. HOLMER. And you do have a fixed deadline under the current statute. But the question is: When do you fire the retaliation missile? When is it? At what point in the negotiation process essentially do you declare failure? Because what you have to do is make sure that you retaliate a sufficiently large number of times or sufficiently frequently so that, when you go into that negotiating room and say, "We have met with the economic policy council, the President has made his decision, we are going to retaliate by a certain date," you get their attention, and that they realize that they are going to have to pay a very, very heavy price if they don't come across.

We have seen that repeatedly with respect to a number of negotiations, including negotiations with the Japanese, over the course of the last 20 months. And the problem from our perspective is that it is not in every single case where you are going to want to fire that gun.

I would submit that if we had been required to retaliate in the EC Enlargement Case, we would have assured that we didn't get an agreement, and you would have had a massive trade war on both sides of the Atlantic. I think that would have been counterproductive to all U.S. interests.

Senator BAUCUS. I see my time is up. But there is always a way to skin a cat. If the deadline is there, and you think it causes some problems, there is another way to compensate. There is always another way to compensate. We are just trying to force the Administration to act much more expeditiously and more quickly.

The CHAIRMAN. Thank you, Senator.

Senator Durenberger.

Senator DURENBERGER. Mr. Chairman, thank you.

Alan, the 1979 end of this table is just reacting to our colleague from Colorado's brief exchange with you, and we can't quite decide whether to feel sorry for you, or for him, or for us, or whatever. [Laughter.]

Senator ARMSTRONG. Would you excuse me for 10 seconds?

Senator DURENBERGER. Of course, after that I would.

Senator ARMSTRONG. To add, Mr. Holmer, to what I said, I didn't mean to be quite as cranky as I may have seemed, because if I were sitting in your shoes I might do the same thing.

I understand that there are times when you need to tell Congress to buzz off and do your job, but I don't think we ought to kid ourselves; that is the impression I get of what you are saying.

Senator DURENBERGER. I am not going to give you 10 seconds to tell Congress to buzz off. [Laughter.]

Alan, I wonder if you wouldn't add one sort of process dimension to the discussion this morning. Maybe you did this in part of the opening statement and I missed it, but there was an implication I think in one of the Chairman's illustrations about comparing Greece with the EEC, or something like that. I am sort of curious for you to explore with us a little bit on the broader dimensions of the decisionmaking process in some of these retaliatory cases, particularly under the aegis of national security. And if we in trade are in transition about administrating some flexibility into trade policy, we know that that is going on in the national security area. And yet, that is one of those areas in which a lot of decisions are made without anybody knowing how the decision got made, or for what reason, and it ends up being your decision; but I suspect it was having been made somewhere else in the process.

So maybe just as a process question you might tell us the way in which the national security or the foreign policy input into this decisionmaking process is incorporated into the decisions. And maybe by illustration tell us why certain decisions that the USTR might like to have taken were not taken, or were postponed, for so-called national security reasons.

Mr. HOLMER. Senator Durenberger, all I can do is explain how the process has worked in the 20 months I have been at USTR. Ambassador Yeutter has made hundreds of recommendations to the EPC and the President, and there is only one that I can think of where his recommendation was not followed, and that was in the footwear case.

What happens as far as the process is concerned is, you start with the Section 301 Committee, and it bubbles up ultimately to the Economic Policy Council, which includes the normal Cabinet agencies, the Departments and Agencies that are concerned about trade. But you also have there sometimes the CIA, always the representative of the National Security Council, and the State Department is always there. And there is an opportunity for those issues to be raised.

I can't think of a single instance in the last 20 months where national security concerns have been allowed to control a decision with respect to what the ultimate Administration response would be.

But the reason I think the EPC, the Economic Policy Council, process works so well is that, if you have a different process and a recommendation goes over to the White House, the paper gets circulated within the White House, and a memo gets slapped on by the OMB Director, and a memo from the CEA and a memo from the National Security Adviser, and as a result you don't really have a chance to respond to those issues from a trade standpoint. And in that sense I think the current process works well, from the perspective of the U.S. Trade Representative.

Senator DURENBERGER. Does the National Security Council today have greater weight in this decisionmaking process than it had when you came on board? Or less? And does it have greater weight, for example, than does the State Department, since the National Security Adviser is proximate to the President on a lot of these isuses?

Mr. HOLMER. I wouldn't really be in a position to judge as to whether or not the State Department or the National Security Council has more or less weight. I can tell you that as the trade deficit numbers have risen, and as the Administration, like the Congress, has become increasinly concerned about the size of that trade deficit, there has been increasing concern over the trade and national economic security issues as opposed to the traditional national security issues. The economic issues have really come to the fore.

Senator DURNBERGER. Thank you.

The CHAIRMAN. Thank you, Senator.

Senator Daschle.

Senator DASCHLE. In response to Senator Danforth's questions with regard to the number of times 301 was utilized in the last 12 years, you said about a half a dozen times. But I was especially interested in your comment that it was heavily weighted toward the last 20 months. I would like to break that down a little bit more, to clarify that.

What was it? How many times was it used, for example, in the first 10 years? Let us exempt the last 20 months. How many times was 301 used prior to that time?

Mr. HOLMER. Prior to this Administration, retaliation was never used under 301. Between 1981 and the Summer of 1985 I believe there were two retaliations. And since the Summer of 1985, when there was really a watershed change with respect to the Administration's approach to Section 301, there have been five public retaliations. Two times the President has publicly threatened retaliation, and there have been a whole series of items where the President directed his U.S. Trade Representative to make it very clear to a trading partner privately that we would retaliate if they didn't come across with an acceptable deal.

Senator DASCHLE. There doesn't seem to be much disagreement that 301 is a very effective tool; you call it "a superb statute." The problem is the reluctance on the part of so many predecessors of yours to utilize Section 301. The frustration that most of us have, I think, is the lack of assurance, the lack of confidence that perhaps after you leave, the same kind of diligence in utilizing 301 will be present as it appears to be now. So that is really what we are seeking—some middle ground perhaps between those who advocate that there will be a continuity in policy in utilizing what you consider to be a superb statute, and this lack of utilization that is so obviously apparent as we look back over the history of 301. How can you give us that assurance? What is it about this superb statute that will give us the confidence that after you leave and for all perpetuity 301 will be used a lot more effectively and aggressively in the future?

Mr. HOLMER. I can't give you any absolute assurance as to what will happen in some future administration after January 20, 1989.

Senator DASCHLE. Well, isn't that the crux, the real pitfall in your argument before us this morning? You can't give us the assurance, and yet you are saying this is such an important statute, this is an important tool.

Mr. HOLMER. Right.

Senator DASCHLE. Well, if we don't have the assurance that someone with your ability and determination is going to use that tool, don't you understand then a little bit better why we are interested in somehow finding a measure by which we can ensure that tool will be used?

Mr. HOLMER. I think there really was a watershed in mid-1985 from which there is no return. And if you feel in the future that any U.S. Trade Representative or any President is not using Section 301 the way you think it ought to be run, all you have to do is to exercise the kind of political leverage that was exercised by this committee and other members of Congress in 1985 and since to assure that we do act the way you want us to act.

The concern I have is, if you put the 301 Program on automatic pilot, and if you say in every case there is going to be mandatory retaliation and in every case the U.S. negotiator is going to be handcuffed, the end result is likely to be less success on the part of your negotiator in opening up foreign markets.

Senator DASCHLE. But you are telling us you don't want that involvement. You are saying that the kind of influence we are exerting right now may be counterproductive.

Mr. HOLMER. No, this is very productive. The letters that we get from the members here, and the legislative proposals—as long as they don't get enacted——[Laughter.]

And all sorts of other kinds of subtle or not so subtle political pressure is very helpful to us in the negotiating process.

Senator DASCHLE. I am confused. [Laughter.]

But let me see if I can clarify something else. You had mentioned that there is a fixed deadline under current statute with regard to the resolution of 301 cases. And yet, if that deadline exists—I'm curious—do they apply to all cases? And what is that deadline? What explains, then, this long drawn-out process by which 301 cases never seem to be resolved?

Mr. HOLMER. The deadlines are seven months for export subsidy cases, eight months for domestic subsidy cases, for GATT dispute settlement cases it is 30 days after the end of the dispute settlement, which can, as indicated in the EC Citrus Case—under prior management it went along for 14 years. That is totally unacceptable and won't happen again under this Administration.

Senator DASCHLE. Well, there you go again.

Mr. HOLMER. And that is why we do believe there you need a legislative fix with respect to deadlines, and you ought to require that there be a decision in those circumstances by the President within 24 months. For all other cases it is a 12-month deadline.

The CHAIRMAN. Senator Wallop.

Senator WALLOP. Thank you, Mr. Chairman.

Mr. Holmer, I have an observation based on experience such as each of us in this committee have had. Each of us have our own sort of special areas of trade which arise from our states or our interests or other things. It has been my experience that in some instances some corporations are very reluctant to trigger the 301, even though they are the victims of unfair trading practices—partly because of integrated corporate structures, partly because they feel, as you have suggested, that in some instances their circumstance might be worse off after it has been triggered than it is in their current set of circumstances. I speak particularly of the trona industry and the soda ash industry in Japan, which has had a case for 301 for some time but has been reluctant to ask that it be brought to the nub of 301, for a lot of rather complex reasons, but I think now they are on the threshold of saying that they would like it.

I guess what I would ask you to comment on is if you know of or can cite an instance or several examples in which the automatic triggering of the 301 would act to the detriment of a manufactured interest in this country, were it to be triggered.

Mr. HOLMER. Well, are you talking about automatic self-initiation?

Senator WALLOP. I am. In other words, I have watched companies seek to avoid getting to that point, exercising every other conceivable route, and I just wondered if you could cite an example of how an automatic triggering of the 301 might work to the detriment of an economic interest seeking the elimination of unfair trading practices.

Mr. HOLMER. Well, one example that comes immediately to mind: There were some people involved in the informatics, the computer sector, who were concerned—I think quite a minority, but some who were concerned—about them having to file a case under Section 301 regarding Brazil's targeting practices for their computer industry. And it is one of the reasons why we wanted to take that on ourselves and to self-initiate that case on behalf of that industry, in order to minimize the negative effect that they might have as a result of them having to file the case themselves.

We can go back and take a look at some of the others and supply that for the record.

Senator WALLOP. If you would, I think that would be helpful.

[The information follows:]

OFFICE OF THE UNITED STATES
TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON
20506

April 8, 1987

Senator Lloyd Bentsen
Chairman, Senate Finance Committee
U.S. Senate
Washington, D.C. 20510

Dear Chairman Bentsen:

During the Finance Committee's March 17 hearing on Section 301, Senator Wallop asked for examples in which a requirement that the U.S. Trade Representative self-initiate investigations could prove disadvantageous to the U.S. industry seeking the elimination of a foreign government's unfair trade practice. In response, I note that during the last 20 months or so, we often have been asked by U.S. industry not to take more aggressive action in certain instances--such as by our aircraft industry against Airbus, our auto industry against certain export performance requirements, parts of our telecommunications industry against Japanese actions relating to optical fibers, various industries (in particular the pharmaceutical industry) against Latin American policies on the protection of intellectual property rights, the computer and computer equipment industries against Korean practices, and the motion picture industries regarding developments in Korea and Taiwan.

I hope the following hypotheticals respond further to the senator's concerns.

o Self-initiation of too many Section 301 cases against one government simultaneously could "overload the circuits." It could reduce or even eliminate that government's political flexibility and willingness to accommodate our concerns in any of the cases, even if it were otherwise prepared to modify one or two such practices. Provoking an inflexible, hostile reaction by a foreign government radically reduces the likelihood of achieving trade reform, and thus sinks the hopes of the U.S. industry hoping to export products or services, or to attain better protection of its intellectual property rights or improved conditions for U.S. investment abroad.

o Self-initiation of a Section 301 investigation can be counterproductive to other efforts already underway to resolve the issue. A foreign government that has already agreed in good faith to seek a prompt solution and is negotiating at the table may view a self-initiated Section 301 investigation as an act of bad faith by the U.S., provoking the foreign government to stonewall the U.S. on its demands for trade reform.

o Self-initiation of a Section 301 investigation of an already controversial, particularly sensitive trade practice may be unnecessarily confrontational. It could fan foreign government and sensationalist press views that such "high-handed" U.S. unilateralism does not merit good faith negotiations by the trading partner concerned.

In summary, the interests of the U.S. industry aggrieved--by inadequate access to a foreign market for its exports, insufficient protection of intellectual property rights or unfair conditions on U.S. investment abroad--are hurt whenever the U.S. provokes a harsh, inflexible, unyielding response by trading partners. In some cases self-initiation can trigger such a reaction, which reduces the likelihood of achieving elimination or significant reduction in the unfair trade practice. Even if the U.S. retaliates in response to the foreign unfair trade practice, retaliation seldom helps the industry seeking improved conditions abroad.

Sincerely,

Alan F. Holmer

Alan F. Holmer
General Counsel

Senator **Wallop**. Let me ask you one other thing along this line. The Bentsen Bill transfers the authority to make an unfairness determination in 301 cases to the USTR, and then the President would keep the authority to decide to implement 301 action based on the USTR's recommendation. I wonder if you would comment on that transfer of authority, and would it enhance or hinder your negotiating ability?

Mr. **Holmer**. Well, two of the things that I keep hearing from members of the Senate and the House about Section 301—and trade policy, generally—they want the President to be more involved in trade than he has been in the past. It seems to me the last thing you want to do, if you want the President to be more involved in trade, is to take decisions off his desk. He will still talk to his National Security Adviser, he will still talk to the Secretary of State, but to the extent that you take off of his desk trade decisions, it makes him less involved in trade. It seems to me that is counterproductive on that point.

The second: What Senator Long was talking about when he established the Special Trade Representative was to have a USTR who was there in the Executive Office of the President, at the right arm of the President as his trade adviser. Proposals to transfer authority to USTR treat the USTR like a normal Cabinet Officer. To the extent that that is done, I think you take away from the special nature of the Trade Representative as a part of the internal White House team. I can't think of any comparable authority that is given legislatively, for example, to the Director of the Office of Management and Budget, or the National Security Adviser. So, in a sense I think that would probably be counterproductive to some of the goals we have about increasing and maintaining the President's role in trade issues.

Senator **Wallop**. Is there a possibility that in the automatic-pilot circumstances that are suggested in these several bills that there would be less of a willingness to determine unfairness if there were no other options, out in the future?

Mr. **Holmer**. The statute requires an unfairness determination in every case. We would try to apply that as objectively as we possibly could. But I think your concern is probably correct, that there will be an instinct on some people to say, "Gosh, if we are going to make an unfairness determination, it means that we are in the automatic-pilot mode, and we are not going to be able to get out of the box that we have placed ourselves in."

The **Chairman**. Senator Heinz.

Senator **Heinz**. Mr. Chairman, thank you.

Mr. Holmer, you have looked at the witness list coming after you, and as I look at that list it occurs to me that just about all of the people on there, including the GAO on the third panel, are here because they believe that notwithstanding all of the efforts that you have engaged in, things haven't worked out very well.

The last witness on behalf of Motorola and the semiconductor industry will tell us that, although the USTR claimed success—and you did, loudly, last year, you didn't get anything from the situation. In spite of your pronouncements, it is no better than it was, and it was egregious before.

Now, I understand you are going back to the table. But in the meantime we have been euchred. We have been taken to the cleaners. And that is true in case after case after case. And, we get the impression that you, who are a very skillful negotiator, together with Mr. Yeutter, are going out and you are negotiating under the Marquis of Queensbury Rules. You know, you have the 12-ounce gloves, and you hit only above the belt, and you are being confronted with not one but a host of people who do full-body contact karate with steel-toed shoes, who kick anywhere they can. And we are a little worried about you, because we really don't see you able to get out of the corner. That you seem to be relegated to the stool—you try your best to get out in the ring, but the other guys just overwhelm you. They feint, they kick, they scream, and we fall. We fall for it. And they just walk off with the purse, and it is often at the grave injury and grave expense to U.S. industries.

Now, the GAO has some pretty harsh things to say about you. They indicate that they talked to 35 301 petitioners, and in fully two-thirds—23 of the 35—the petitioners felt, notwithstanding the fact that you may or may not have had some effect on the unfair practice, that the result of what you had done was that there was no net effect on the injury cited, and in many cases it got worse. What do you have to say about that? These are all cases since January of 1980.

Mr. HOLMER. The first draft of the GAO report which I have read—and I haven't read the most recent version of it—seemed to me to place a disproportionate amount of attention on the earlier time period, 1974 to 1985.

Senator HEINZ. Not this one.

Mr. HOLMER. You cited statistics that apply since 1980. I would submit—and I apologize for repeating it so frequently, but I think it bears repeating—there was a watershed in 1985. You have had a far, far more aggressive Section 301 program since then.

Senator HEINZ. We talked about 1985. And 1986, we talked about your success with the Japanese on semiconductors. Let us not kid ourselves. We have got a record here, and playing a few new pop tunes isn't really going to change the way the music is scored.

Mr. HOLMER. We negotiated that agreement with the Japanese on semiconductors with the semiconductor industry at our side. Yes, we said it was a good deal, and the industry said it was a good deal. The Japanese thus far have not fully lived up to it. We are in the process of doing a review; and, if our review is that they have not lived up to it, I am confident there will be strong actions taken by the U.S. Government.

Senator HEINZ. Let me interrupt you, because I am about out of time. Let us take the Pasta Case filed in 1981. Right now the pasta industry, which is represented on the panel that is coming up, is facing a subsidy by the EC of roughly 60 to 70 percent of the wholesale value of the pasta. And what the United States has done about it, what you have done about it, is nothing. In fact, it is worse than nothing. You dropped the proposed retaliatory tariff on pasta in order to get a citrus settlement, and you have essentially buried the 301 that was filed—well, it was first initiated in the 1970's but it was first formally filed in 1981. What do you have to say to that?

Mr. **Holmer**. The Pasta Case was a complicated one. You had a situation where we did get a favorable panel report out of the dispute settlement mechanism——

Senator **Heinz**. And we ignored it. Here we win one, and where are we. My time has expired, but if I seem excited it is because I enjoy pasta, because my wife is part Italian. [Laughter.]

But if I seem excited, here is one where the GATT panel agreed with us, and right now the pasta people have nothing to show for it. You know, it is time to stop noodling around and put some starch into our policy. [Laughter.]

Thank you, Mr. Chairman.

The **Chairman**. Really, I thought that was a great close. I think we will now go to Senator Bradley.

Senator **Bradley**. Thank you, Mr. Chairman.

Mr. **Holmer**. I will respond for the record, Mr. Chairman.

Senator **Bradley**. About the noodles?

Mr. **Holmer**. Yes.

The **Chairman**. Go ahead. We won't charge you to Senator Bradley. Let us hear what your response is to the noodles.

Mr. **Holmer**. Two things, Senator Heinz. What you had in 1983 was a situation where we did get a favorable panel report, but there was a split in the subsidies code as to whether or not they were willing to adopt that panel report. Ambassador Yeutter has established a deadline of July 1 for that case. We have had three rounds of negotiations, alternating between capitals with respect to the pasta case. And I think you and others on the committee are going to hold our feet to the fire to make sure that there is an acceptable resolution as of July 1.

The **Chairman**. Well, we're pasta that one now. Let us hear from Senator Bradley. [Laughter.]

Senator **Bradley**. Thank you very much, Mr. Chairman. I won't try to top the Chairman.

Mr. Holmer, what I would like to do is to see if we can agree on the objective. I mean, we can get caught up in the specifics of individual 301 cases, but I think it is important to look at the overall objective and how the system works and see if we are on the same wavelength, the committee and the USTR. Would you agree that the more trade there is, the more freely goods cross borders, and that the greatest number of people will benefit?

Mr. **Holmer**. Yes.

Senator **Bradley**. And would you agree, similarly—the flip side of that—that the more there are barriers in the world, the less we will be able to reach our growth potential?

Mr. **Holmer**. Yes.

Senator **Bradley**. So, we are not talking about objectives here, we are talking about a situation in which one country does have a barrier, another country doesn't have a barrier, and you are trying to get access to the market of the country that has the barrier. Is that not correct?

Mr. **Holmer**. Well, that is often the case in Section 301 cases that are brought.

Senator **Bradley**. Right. Okay.

Mr. **Holmer**. But we have our barriers, too.

Senator **Bradley**. So, would you say that one of the arguments for having open trade, and open trade benefiting the greatest number of people, is that it basically is the most efficient way to do business? You know, you trade, goods flow, not long delays, et cetera.

Mr. **Holmer**. Yes.

Senator **Bradley**. You need a widget, and it can be produced in Country-Y, and you get it from Country-Y.

Then the question is whether you maximize efficiency. In a world where there are some barriers, and the goal is to break them down, whether you maximize efficiency with mandatory retaliation or with long political delays.

Why wouldn't you maximize efficiency if a country knew that there would be mandatory retaliation? You then wouldn't have lengthy delays in the political process working its pressure on you, delaying. The company that wanted the widget would know that if the barrier is not gone by a specific date, there is going to be retaliation. Why wouldn't that maximize efficiency?

Mr. **Holmer**. I guess I would look at it the other way. I have always found as a negotiator, the best way to negotiate is to put myself in the other guy's shoes. And I know how I would react if a trade negotiator sat down with me and said, "We are sick and tired of the United States' unfair trade practices. Get rid of your quotas on steel and textiles and machine tools and sugar and sugar-containing products, and cotton, and all the rest." We have difficulty doing that; they are going to have difficulty doing it on their side.

If you apply the same standard across the board with respect to every product and every practice, even though it may be unjustifiable based on our definition of what is unjustifiable, you are obviously going to result in a market-closing response.

Senator **Bradley**. But don't you want to remove the incentive for a country to put up barriers?

Mr. **Holmer**. Absolutely

Senator **Bradley**. And if you know there is going to be retaliation, it seems to me that you know going in that you are going to have some pain if you put up a barrier. And if you don't have mandatory retaliation, you then find yourself in a position of hoping that you have got your person who will be able to work the political process so your case is the one that is excluded for broad political reasons.

Mr. **Holmer**. The problem often is going to be that if you say absolutely, at a time-certain deadline, you are going to have mandatory retaliation—no exceptions—you are going to end up in some instances with a nationalistic backlash in a country that is going to reduce their trade negotiator's flexibility to be able to get that trade barrier down.

Senator **Bradley**. Now, I did a little quick calculation. We had about 1-2-3-4-5-6-7-8-9-10-11—we had about 12 cases settled in just the last—what?—year and a half. Now, wouldn't you say that the President had no effective discretion in these 301 cases in the last year and a half? You say that it was political pressure from The Hill, but the result was that the President didn't have discretion in these; you had to settle, wouldn't you agree?

Mr. **Holmer**. I am not sure which cases you are referring to.

Senator Bradley. Well, let's see. Do you want me to read them? Settle the tobacco dispute with Japan through an agreement, settle the insurance industry's dispute with Korea, settle the intellectual property dispute with Korea, settle the Customs valuation dispute with Taiwan, settle the wine and tobacco dispute with Taiwan, settle the software-lumber dispute with Canada, settle an EC citrus case, settle the dispute involving the Spanish and Portugese ascension to the EC—for openers.

Mr. Holmer. That is not a bad record. But if you go through those, in most of those instances there are instances where we did say Yes, mandatory retaliation. The question is, if you would have the language in S. 490, would we have been able to get that same market-opening response? I am not sure. I am reasonably confident that if you look at the EC enlargement case, that one would have been long gone. If we had not had the flexibility that we have under current law, you would have had a retaliation spiral that could have gotten out of control, and you would have had a trade war between ourselves and the Europeans.

The Chairman. Gentlemen, I must ask that we move along.

Senator Matsunaga.

Senator Matsunaga. I will pass, Mr. Chairman.

The Chairman. Senator Rockefeller.

Senator Rockefeller. Mr. Chairman, I apologize; I was at Commerce, and I missed a good deal of what has happened here, so I am not sure of all the questions.

The fact is that we are slipping, Mr. Holmer, and I don't think anybody disagrees with that. We are told by the Administration that we must have flexibility, and we are told by the Administration that there have been record numbers of 301's over the last year and a half. But we are losing a million jobs a year. Half the newly created jobs pay $7000 a year or less.

And there is a philosophical question, I guess, along with what Bill Bradley is saying, as to what is the objective in all of this. You don't want retaliation forced down your throat by the Congress because it takes away your flexibility. Our reaction is that although 301s are initiated, in most cases they are delayed. It is a very long process. And if it is GATT related, it can be a very, very long process. There are lost jobs; we are unable to compete with foreign trade barriers. The entire country is more aware of the problem as they watch jobs disappear from their communities, and, therefore political pressure rises in this process.

Let me just ask you this: If the President decided tomorrow, for example, to act under Section 301 against Japan in, let's say, several different ways on half a dozen cases without a preceding formal USTR investigation, for example, on Kansai, supercomputers broadcast and earth resources satellites, and others—you would say, "Let's not do this." But these are areas where we are highly knowledgeable. We know exactly what we are doing; we know exactly what they are doing. We understand what their barriers are; we understand the Japanese system. It is not working for us. It is not fair.

Now, the President tells the Japanese that, unless the market in these areas that I have just mentioned is opened up by, let's say, June 17, the day before my birthday, we will take retaliation in the same general areas. Would you describe to me what damage would take place, would they retaliate, how would they retaliate. What do you see happening as far as damage to this country?

Mr. HOLMER. It may be that we are going to see between now and June 17 how it is that the U.S. Administration is going to respond to semiconductors and supercomputers and Kansai, and a few other issues that really are reaching flashpoints. And the response that we get from the Japanese on those issues is going to dictate (1) how we respond, and (2) what our overall strategy is going to be.

But specifically, how would they retaliate against us, if they would? As I recall, Japan is the largest U.S. agricultural export market, and they are going to hit corn sorghum, they are going to hit wheat grains, they are going to hit aircraft and a number of other areas, presumably, if they decided that they want to retaliate.

The other question that you ought to be asking, though, consistent with the objective that we all have, is what is this going to do to help U.S. exports of semiconductors or supercomputers or U.S. involvement in the construction of the Kansai Airport? And that is one of the problems with retaliation. Retaliation, for the most part, marks failure. It means, "We are never going to get that—but we feel it is so important to the credibility of our Section 301 program, and we find those practices so objectionable, that despite the fact that it is likely to result in a market-closing response, we are going to take that response."

Senator ROCKEFELLER. And the fact that you say it is likely to result in a market-closing response is based on what history?

Mr. HOLMER. I would cite the EC Citrus Case, where we retaliated against the EC with citrus.

Senator ROCKEFELLER. With the Japanese.

Mr. HOLMER. With the Japanese. We would base it principally on the intelligence that we had in the Rice Case and based on other relatively informal intelligence that we have from the Japanese.

I cannot cite you a specific example where we have retaliated against them and they have counter-retaliated against us.

Senator ROCKEFELLER. Thank you, Mr. Chairman.

The CHAIRMAN. Gentlemen, we are going to have to move ahead. We have two more panels and a limitation on time. We wouldn't have this problem if it wasn't for the intense interest of the members. We have almost full attendance here, and I am delighted to see that. It shows how much interest we have in this piece of trade legislation, and in this instance Section 301.

Mr. Holmer, your testimony has been helpful, interesting, and I wish I could say I agreed with all of it. Thank you.

Mr. HOLMER. If I could, Mr. Chairman, I just want to emphasize how much Ambassador Yeutter and the rest of us want to work with you and the members of the committee in crafting a bipartisan bill that we can all support, and we are ready to work evenings and weekends with you and your staff in that effort.

The CHAIRMAN. Mr. Holmer, we are delighted to have the cooperation. I appreciate that. Thank you very much.

Mr. HOLMER. Thank you, Mr. Chairman.

[Mr. Holmer's prepared statement follows:]

TESTIMONY

OF

ALAN F. HOLMER

GENERAL COUNSEL

OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE

Mr. Chairman and Members of the Committee, I am pleased to have this opportunity to comment on legislative proposals to amend Section 301 of the Trade Act of 1974. The Administration wants to work with you on these and other legislative proposals. Our 1,600-page competitiveness bill was transmitted several weeks ago; we hope it will receive your careful attention.

In the last 20 months, we have achieved a series of unprecedented firsts under Section 301:

- Four times the President directed the Trade Representative historically to self-initiate investigations, to underscore to the governments concerned our serious displeasure with their unfair activities and our unshakable determination to obtain a satisfactory settlement.

- Three times the President unprecedentedly announced his determination to retaliate if necessary against unfair foreign government practices, without having conducted a formal investigation under Section 302 of the Trade Act.

- Unlike any other President, President Reagan retaliated or publicly threatened to retaliate seven times in the last 18 months. These actions achieved satisfactory solutions not otherwise possible in those particular cases. Even more importantly, they established beyond question the credibility of the threat of retaliation, enhancing our prospects for successful outcomes in all other Section 301 cases.

- For the first time since Japan limited imports of leather and leather footwear over 35 years ago, we obtained compensation for those GATT-illegal quotas.

- We used Section 301 for the first time to obtain dramatically improved protection of intellectual property rights (in Korea).

- Likewise we made initial use of a companion provision to Section 301 (Section 307 of the Trade and Tariff Act of 1984) to achieve elimination of export performance requirements in the automotive sector in Taiwan.

- The Administration historically combined the use of Section 301 with the antidumping law to achieve an agreement on trade in semiconductors that, if properly implemented by Japan, will significantly benefit our semiconductor industry.

- The Administration also used Section 301 to resolve an otherwise unbridgeable impasse in the negotiation of a softwood lumber agreement with Canada. When Canada could not collect quickly enough a tax on softwood exports to the U.S., the President imposed an import tax under Section 301.
- The Trade Representative has used Section 301 forcefully to remind trading partners that they must, at a minimum, live up to the obligations they have already assumed. For example, when Taiwan reneged on its commitment to apply the GATT Customs Valuation Code, the President's decision to retaliate quickly convinced the Taiwan authorities of the wisdom of compliance with their obligations.
- Recently we obtained full compensation when the EC withdrew or impaired trade concessions in connection with its enlargement to include new member states (Portugal and Spain).

In fact, I believe it is precisely our dramatic Section 301 successes that have fueled legislative proposals to ensure that this trade remedy is used more frequently, to resolve more trade barriers. Ironically, the nonselective, routine use of Section 301 required by S. 490 would radically reduce its effectiveness.

To be more specific, Mr. Chairman, I will identify precisely the proposals in S. 490 that trouble us most, and specify briefly the reasons why, after first reviewing the Administration's Section 301 proposals. I will also describe similar proposals in the House Trade Subcommittee bill. In considering any proposal to amend Section 301, I hope the Committee will apply the following yardstick: Does the proposal help or hurt the ability of U.S. negotiators to pry open foreign markets to U.S. exports?

The Administration's Proposals

In our bill, we proposed three major amendments to Section 301. First, we want to establish that reciprocity is a factor to be taken into account as appropriate in deciding whether a foreign government's act, policy or practice is "unreasonable," one of several bases for action under Section 301. While reciprocity alone should not necessarily be dispositive, it merits appropriate consideration by the President in making this determination.

Second, we propose to require the Trade Representative to report semiannually to the Congress on the commercial effects of recent Section 301 actions. The principal aim of the Section 301 program is to increase access to foreign markets and to improve the protection of intellectual property rights. An important measure of its success is the actual effects on U.S. commerce; for example, whether market-liberalizing agreements make the cash registers ring with increased sales of U.S. exports of goods and services, and whether U.S. retaliation hurts U.S. commerce more than the foreign country at which it is aimed. When these effects are significantly positive, we want you to appreciate our achievements. And when they are disappointing, we ought to know why and take appropriate remedial action.

Third, in trade agreement (usually GATT) cases, we propose to require the Trade Representative to make his recommendations to the President within 24 months of initiation, even if international dispute settlement continues. While we propose to improve GATT dispute settlement markedly in the Uruguay Round, in the meantime we will not be held hostage to prolonged international proceedings.

Let me turn now to the major proposals in S. 490.

Mandatory Retaliation

When Ambassador Yeutter testified before this Committee last July, he explained why the Administration strongly opposes any legislative mandate to retaliate in Section 301 cases. The rigid requirement to retaliate--a unilateral, draconian action--on an arbitrary time schedule could provoke an emotional, nationalistic reaction in another country and reduce its government's flexibility to negotiate an acceptable resolution. It would make retaliation more likely, and thus close the U.S. market rather than open up a foreign market.

The retaliation requirements in S. 490 are more onerous than those in other major bills. S. 490 limits drastically the discretion available in cases involving "unjustifiable" actions. The only exceptions provided in such cases are: a GATT Council finding that the practice is not unfair; the foreign government's elimination of the unfair trade practice or of the burden or restriction on U.S. commerce; or an agreement approved by the petitioner or domestic industry, completely offsetting the unfair trade practice. S. 490 does not provide an exception if action under Section 301 would not be in the national economic interest of the United States. To require action adverse to the economic interest of the U.S. would be most inadvisable. Moreover, the GATT Council exception is too narrow, and should be expanded to include GATT panel action as well. In addition, U.S. industry should not be given the authority to accept or reject a settlement agreement. The President, not perhaps a single chief executive officer of a U.S. corporation, should determine whether an agreement with a foreign government best serves our national economic interests.

S. 490 provides some additional flexibility with respect to other practices actionable under Section 301. In these cases, S. 490 would exempt the President from the requirement to retaliate if he certifies to the Congress that elimination of the unfair practice was impossible to achieve, and that action under Section 301 would not be in the national economic interest. However, even with this incremental additional flexibility, this proposal too remains objectionable. In most current cases, the President acts or decides not to act on a timely basis. In some cases, however, we prefer to keep his options open and to reserve his right to act under Section 301 in an appropriate way at an appropriate time. We do not think it would be helpful to our campaign against trade barriers to "certify" that success was "impossible" and that any action under Section 301 would not serve the national economic interest.

The House Trade Subcommittee proposals, on the other hand, require retaliation only in cases involving violations of trade agreements or other "unjustifiable" practices. Under these proposals, the President retains full discretion in all other Section 301 cases. Where retaliation is the rule, the House Subcommittee proposals provide the following exceptions:

(1) the GATT Council or a GATT panel finds that the practice is not unfair; or

(2) the President finds that:

> (a) the foreign government is taking satisfactory measures to grant U.S. trade agreement rights;
>
> (b) the foreign government has agreed to eliminate or phase out the objectionable practice or to remove the burden on U.S. commerce;
>
> (c) it is impossible to achieve (a) or (b), but the foreign government agrees to compensate the U.S.; or
>
> (d) action under Section 301 is not in the national economic interest (because the results of action would be more adverse than inaction), and the President reports the reasons to the Congress.

Mandatory Self-Initiation

With respect to requirements to "self-initiate" Section 301 investigations, S. 490 again provides different rules for "unjustifiable" than for other practices actionable under Section 301. The Trade Representative would be required to self-initiate investigations of all practices likely to be "unjustifiable" identified in the annual National Trade Estimate Report. With respect to other actionable practices, S. 490 provides limited discretion. Self-initiation would be not required if, after consulting with the domestic industry, the Trade Representative determined that initiation would be detrimental to other efforts underway to eliminate the unfair practice.

Rigid self-initiation requirements for "unjustifiable" actions would reduce the possibility of achieving a satisfactory market-opening outcome. The Administration needs the broadest possible discretion to pick the tool best tailored to each particular case. While Section 301 is a valuable tool, it is only one of many in our trade workshop. S. 490's inflexible self-initiation requirements would reduce our ability to resolve trade problems, by tying our hands and dictating the choice of the tool with which to work, regardless of the particular facts and developments in each situation.

The self-initiation requirements in S. 490 for other practices actionable under Section 301 also are troublesome. Self-initiation currently has clout because it is extraordinary. By calling for regular, routine self-initiation of investigations, these provisions would turn front page news achieving immediate, high level concern abroad into a page 42 filler noticed only by mid-level foreign bureaucrats. Even worse, they unintentionally relegate all other trade disputes to second class status. Mandatory self-initiation requirements cast a deep, sleepy shadow over all trade issues on which the Trade Representative does not self-initiate an investigation.

The House Trade Subcommittee proposals do not require self-initiation of any Section 301 investigations.

Unfairness Determination

S. 490 requires the Trade Representative, in all cases, to determine formally and publicly, on an arbitrary time schedule, whether a practice is unfair under Section 301. We will get better results if we continue to decide in each case whether such a determination increases our leverage, and if so when and how to play this negotiating chip. Occasionally a trading partner feels so threatened by the stigma of an unfairness label that it is willing to grant more concessions if we simply refrain from branding its conduct unfair. In other cases, we may wish to make a determination, but on a time schedule different from the deadlines established by S. 490. For example, if a GATT panel is considering this issue on a timely basis, a premature, unilateral U.S. determination could antagonize the panel and provoke an unfavorable ruling. In still other cases, there may be serious disagreement whether the practice is unfair. In these circumstances, compelling the Trade Representative to make a formal determination could result in a negative decision--giving a green light to the foreign government to continue its practices without fear of U.S.

reprisals. Under current law, by contrast, we can sometimes use Section 301 to achieve trade concessions from our trading partners even if the foreign practice is not unfair.

Like S. 490, the House Trade Subcommittee proposals require the Trade Representative to make a formal, public determination of unfairness in every Section 301 case. They also expedite this determination in targeting cases.

We prefer to retain discretion as to whether and when to make unfairness determinations. And in any event, we see no justification for requiring determinations sooner in targeting cases than in other cases.

Transfer of Authority

Like the House Trade Subcommittee proposals, S. 490 transfers from the President to the Trade Representative the authority (and requirement) to determine, on an arbitrary time schedule, whether a foreign government's act, policy or practice is actionable under Section 301. Such a transfer would simultaneously diminsh the President's ability to lead and the USTR's ability to negotiate. We would be signaling to the world that our President will be less interested and involved in trade in the future. We want the President to remain personally involved, because that presence is often needed to induce a foreign government to accommodate our concerns.

As a practical matter, moreover, any Trade Representative will seek the advice of other interested agencies in controversial matters in any event. Therefore, the proposed transfers of authority would not significantly change the way unfairness decisions are made.

State Trading

The Section 301 proposals in S. 490 on state trading are--like this subject--complex. The Administration shares the Congress' interest in making Article XVII of the GATT effective and operational. We share the view that Article XVII has an important role in an improved international trading system. We have made this point repeatedly in the GATT, most recently in the first meeting of the Negotiating Group on GATT Articles in Geneva. Other governments share our interest in this Article and the need to make it relevant to the trading system.

We have serious concerns about the specific proposals in S. 490 unilaterally defining state trading. Adoption of those provisions would effectively pre-empt the GATT process just as it is starting. We are developing our negotiating strategy on this issue in close consultation with the private sector, and it will obviously be incorporated into any Executive/Congressional consultation process.

The provisions on state trading in S.490 parallel the provisions of S.2660, introduced in the last session of Congress. We expressed a number of reservations about the specific methods chosen to unilaterally interpret Article XVII at that time. Those concerns are only intensified by the initiation of formal GATT negotiations. The categorization of state trading practices as "unjustifiable", thereby triggering the most severe self-initiation and retaliation requirements, is simply not warranted given the current international ambiguity. Nor is it at all clear that our antidumping standard of "constructed value" is the only, or even most appropriate, alternative standard for Article XVII's "commercial considerations" test.

The House Trade Subcommittee proposals do not include analogous state trading provisions.

Time Limits

S. 490 establishes some new time limits regarding action, not just a decision, by the President. No matter how much time is provided, there will be some cases in which we need more time --because of pending elections, student riots, a nuclear disaster, a ministerial scandal, a general strike, or other critical developments in the foreign country that radically reduce its government's negotiating flexibility for the time being. The President must continue to have the flexibility to postpone action when he determines that this best serves the overall economic interests of the United States.

The House Trade Subcommittee proposals change only the time limit for the Trade Representative's recommendations to the President in trade agreement (usually GATT) cases, from the current standard to 18 months (5 months for bilateral consultations, 13 months for the formal panel process). The time limits for the Trade Representative's recommendations in other cases remain unchanged. Generally the President would be required to make his decision and act within 30 days, although he would be permitted to delay implementation of retaliatory action for up to 6 months (if petitioner or the domestic industry requests delay, or he determines that substantial progress is being made or that delay is necessary and desirable to achieve a satisfactory solution).

Export Targeting

We don't think any export targeting amendment is necessary; the Japan Semiconductor and Brazil Informatics cases reflect the availability of current law and our readiness to apply it. Moreover, S. 490's definition of targeting is unreasonable, because it defines as unreasonable some practices expressly permitted by international agreements to which the U.S. is a party. For example, the "laundry list" of illustrative export targeting practices includes: (1) protection of the home market, which GATT expressly authorizes for developing countries in some circumstances; and (2) noninjurious domestic subsidies, which the GATT Subsidies Code expressly blesses. To characterize such actions as unreasonable would provoke self-righteous, indignant foreign responses and hasty retaliation against U.S. exports.

Moreover, the likelihood of mirror targeting legislation is dangerous to U.S. exports because they, too, benefit from what S. 490 describes as targeting. For example, U.S. crude oil and gasoline production benefits from higher Superfund taxes on imports than on domestic products; until recently from special depletion allowances and favorable expensing of drilling; and some time back from outright quotas on imports. Our trading partners might well consider this a "government plan or scheme consisting of a combination of coordinated actions ... bestowed on a specific enterprise, industry or group thereof the effect of which is to assist the enterprise, industry, or group to become more competitive in the export of a class or kind of merchandise."

Think about the effects on U.S. agricultural exports if S. 490's targeting provisions were mirrored abroad by our trading partners. Other governments could try to characterize numerous U.S. actions as targeting measures. Wheat farmers, for example, have received substantial assistance under our export enhancement program, significant deficiency payments under the 1985 farm bill, and the benefits of USDA and U.S. & Foreign Commercial Service export promotion programs and assistance. Our rice industry has received sizable marketing loans under the 1985 farm bill, obtained certifications under the Export Trading Company Act protecting their export ventures from suits under the antitrust laws, benefited from countervailing duties on Thai rice imports without any finding of injury caused or threatened by those imports, and is receiving special attention by the U.S. Government in the Uruguay Round. Likewise our lumbermen fought for and won the Timber Contract Relief Act of 1984, a reversal of Commerce's 1983 decision that Canadian stumpage programs were not countervailable subsidies, the recent conclusion of an agreement with Canada taxing Canadian softwood exports to the U.S., and the formation of the export joint ventures with antitrust immunity under the Export Trading Company Act. The golden rule of international trade is "what we do to them, they'll do to us."

The House Trade Subcommittee proposals define export targeting broadly, and do not include a laundry list of illustrative targeting practices. Where the Trade Representative determines that export targeting is a significant burden on U.S. commerce, the President would be required to take action, unless such action is not in the national economic interest (because such interest would be more adversely affected if action were taken than if it were not), and the President reports the reasons to Congress. Where the national interest waiver is exercised, the President must convene a private sector panel of experts to advise on measure to promote the industry's competitiveness. Action is discretionary if the export targeting only threatens to be a significant burden on U.S. commerce. Action includes retaliation and agreement by the foreign government to an imminent solution to the significant burden or to provide compensation satisfactory to the President.

Proposals Adopted by the House Trade Subcommittee And Not in S. 490

The House Trade Subcommittee proposals do not include all Section 301 proposals in S. 490; for example, provisions on mercantilism and state trading, or compulsory licensing of technology. Conversely, the House Subcommittee proposals include measures not provided in S. 490. These include:

- the Administration's reciprocity proposal;
- the Administration's semiannual report to the Congress on the commercial effects of recent Section 301 actions;
- when the President acts under Section 301, a requirement to give first consideration to action on the same goods or sector or to compensation on the same goods or sector;
- a provision defining as "unreasonable" denial of certain internationally recognized worker rights (which we will address in detail at tomorrow' hearing);
- a provision authorizing certain procedures in Section 301 investigations, such as consultations with the private sector, verification of information provided by the foreign government, and use of best information available if the foreign information is not timely, complete, adequate or sufficiently documented or verified;
- a requirement before acting under Section 301 to take into account the likely impact such action would have on U.S. agricultural exports.

Adversarial Trading

S. 490 requires the Trade Representative to determine whether countries identified as having significant trade barriers in the National Trade Estimates Report maintain a "consistent pattern" of barriers and market distorting practices. With respect to such countries, the President is required to initiate negotiations to eliminate all such barriers. By December 31, 1988, the President must report to the Congress on any agreements reached and commitments made; any evidence of increased U.S. exports as a result; and any evidence that the level of U.S.

exports is what reasonably would have been expected to result from elimination of all such trade barriers.

The rough analogue to these provisions in the House Trade Subcommittee proposals is a modification of an H.R. 3 proposal sponsored by Congressman Gephardt. Under the House Subcommittee proposals, the International Trade Commission is required to identify countries with an excess bilateral trade surplus with the U.S., based on specified criteria. The Trade Representative would then determine whether any "excess surplus" country maintains a pattern of unfair trade practices that have a significant adverse effect on U.S. commerce and contribute to the excessive trade surplus of that country. The Trade Representative is required to enter into negotiations with each such country to achieve a more balanced, reciprocal bilateral trade relationship through a substantial reduction of either (1) the "unwarranted" practices or (2) the effects of such policies on U.S. commerce. If no agreement is achieved within six months (or eight, if compelling reasons warrant an extension), then the Trade Representative is required to take action against the unfair trade practice. However, the Trade Representative could waive retaliatory action against "unjustifiable" practices if retaliation would cause substantial harm to the national economic interest; or against other unfair practices if the economic harm of retaliation would exceed the harm caused by the foreign unfair practice. Any waiver would be subject to Congressional override.

Finally under the House Subcommittee proposals, the Trade Representative would be required to determine whether any excess trade surplus country maintains its currency at an artificially low level. If so, he must negotiate with each such country to seek a more realistic realignment of its currency. If negotiations are unsatisfactory, he may take action under Section 301, including imposition of an "exchange rate equalization tariff."

Our fundamental objection to these proposals is that they contemplate a balancing of bilateral trade through trade policy actions rather than addressing the problem of large external balances through macroeconomic policies. While they are a substantial improvement over the original provisions in H.R. 3, they still mandate retaliation, and require us to dub a country as an unfair trader (which is likely to provoke a nationalistic backlash that reduces prospects for negotiating a satisfactory solution).

Moreover, these proposals inappropriately delegate authority for monetary policy and negotiations to the Trade Representative. They unnecessarily require exchange rate negotiations in which the Administration is already engaged. And they make it harder for such delicate negotiations to succeed, by thrusting them into a glaring spotlight.

Mr. Chairman, these are our comments on S. 490's Section 301 amendments and our description of the comparable provisions in the House bill.

We look forward to working with you and your staff on these proposals; I'd be happy to respond to your questions.

The **Chairman**. The next panel will be one consisting of Mr. Phillip O'Reilly, who is Chairman and Chief Executive of Houdaille Industries, on behalf of the National Machine Tool Builders Association. Mr. Reilly, would you come forward?

And we have Mr. Julian Morris, President of Automotive Parts and Accessories Association; Mr. Robert Ronzoni, who is the President of Ronzoni Foods Corporation, on behalf of the National Pasta Association; Ms. Veronica Haggert, who is Vice President of International Trade for Motorola, Inc., on behalf of the Semiconductor Industry Association; and Mr. J. Stephen Gabbert, who is Executive Vice President of the Rice Millers Association, to be accompanied by Mr. Bart S. Fisher, who is the Counsel for the Association.

Senator **Chafee**. Mr. Chairman?

The **Chairman**. Yes?

Senator **Chafee**. Before this panel gets started, Senator Rockefeller made a reference to the new jobs that are being created. There seems to be a good deal of dispute over this question of whether these new jobs are $7000-a-year jobs or not.

For my edification, I would appreciate it if Senator Rockefeller could submit for the record the basis from which he derived that information of the wages of these newly-created jobs.

Senator **Rockefeller**. I will do so.

Senator **Chafee**. I have just heard that there are differences of opinion on this question. I am not sure—you may be perfectly right. And it would be helpful to me if we could have the derivation of those statistics.

The **Chairman**. Would the Senator respond to that?

Senator **Rockefeller**. I will do so.

To initially explain and document my remarks regarding the trend of low-wage jobs making up an increasing share of the newly created jobs in America, I submit for the record the following article published in the New York Times on February 1, 1987. This summarizes a study commissioned by the Joint Economic Committee and released in January 1987.

The **Chairman**. All right, Mr. O'Reilly, we have you scheduled first. If you would, proceed with your testimony.

[The information follows:]

Forum

A LOW-WAGE EXPLOSION

The Grim Truth About the Job 'Miracle'

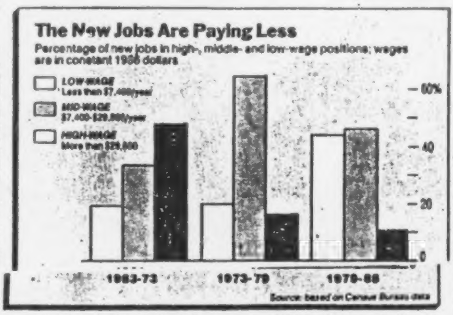
By BARRY BLUESTONE
and BENNETT HARRISON

THE American worker is in trouble. Despite all the talk about job growth in the 1980's, the overall unemployment rate for the past year remains essentially unchanged from its 1980 recession level. Since the early 1970's, average wage and salary incomes adjusted for inflation have been declining for nearly all groups within the population and in most industries.

Even more disturbing is the proliferation of low-wage employment. Between 1979 and 1985 — the most recent year for which Government data are available — 44 percent of the net new jobs created paid poverty-level wages. This was more than twice the rate of low-wage job creation that prevailed during the 1960's and 1970's. And while millions of new, high-wage professional, technical and managerial jobs were created during the 1980's, this growth was only a third the pace of high-wage job creation between 1963 and 1979.

We think these developments are explained — at least in part — by plant shutdowns, foreign imports (including imports from the offshore plants or partners of American companies), subcontracting of production to lower-paying suppliers, employer mandated wage freezes and take-aways, the proliferation of involuntary part-time work schedules and personnel cutbacks associated with corporate restructuring plans. Since none of these developments is likely to change in the near future, we should probably expect the disturbing trend toward low wages to continue.

In our research on job creation, we investigated employment trends for three periods of roughly consistent economic conditions: 1963 to 1973 (from the inauguration of the Great Society programs to the first OPEC oil shock), 1973 to 1979 (the years between the first oil shock and the beginning of counter-inflationary monetary restraint) and 1979 to 1985 (the third year of the current recovery). We calculated net employment growth during each of these periods, as well as the proportion of the growth that can be considered "low-wage," "mid-wage" or "high-wage" relative to the median annual wage and salary income level in 1973.



Source: based on Census Bureau data

We called a job low-wage if the worker earned no more than half the 1973 median wage after accounting for inflation. We chose 1973 as our benchmark because that was when real average annual wages reached their post-war peak. We defined high-wage jobs as those paying more than twice the 1973 median, again after taking inflation into account. Stated in terms of 1986 purchasing power, a low-wage job pays $7,400 or less. A high-wage job pays in excess of $29,600.

What do we know about the latest period (1979-85) of job growth? Census Bureau data indicate that 9.3 million net new jobs were generated in these years. Of these, more than two out of every five (44 percent or four million) were in the low-wage category. In the same period, the high-wage share of new job creation grew by only about 10 percent, or 965,000.

By contrast, consider the years before 1979. Between 1963 and 1973, the economy generated almost 20 million new jobs. Of these, fewer than one out of five were low-wage and almost half were high-wage. In the following period (1973 to 1979), despite oil shocks and economic stagnation, another 12 million jobs were created. Again, only one out of five were low-wage, while roughly one out of every six paid annual wages above $29,600.

There has been much discussion of late about the decline of the "middle class." The accompanying chart shows that the share of all new jobs paying what we call a mid-level wage ($7,400 to $29,600) nearly doubled from the 1960's to the 1970's, but then fell by almost 30 per cent in the 1980's. (These results hold up regardless of the inflation factor used — the Consumer Price Index or the Personal Consumption Expenditure index.)

The increase in poorly paid jobs is not restricted to minorities and women. Since 1979, nearly three-quarters of the net job gains of white men have been at the low end of the spectrum — more than for any other demographic group. The wage gap between men and women (and between whites and minorities, as well) has indeed closed somewhat in the 1980's, but this is due almost entirely to declines in white men's wages — not to expanding incomes of other groups of workers.

NOR has the growth in low-wage employment been restricted to young people, as is commonly asserted. If we use age 35 as a cutoff, 27 percent of the net new jobs going to older workers since 1979 paid less than the $7,400 standard, compared with only 16 percent during the 1970's. And the low-wage phenomenon is by no means restricted to the most severely depressed Midwestern states or merely to the manufacturing sector. Only the booming Northeast shows a declining low-wage-job share in the 1980's. And, as with mature manufacturing, "high tech" industries and the "services" (including retail trade) have seen their low-wage ranks swell since 1979, relative to earlier years.

One explanation for the surge in low-wage jobs in the 1980's is the dramatic expansion of part-time employment — jobs offering less than 35 hours of work a week. Between 1979 and 1985, part-time jobs grew twice as fast as full-time jobs, accounting for nearly 30 percent of total net employment growth. Some analysts embrace this development as a sign of improvement in the "flexibility" with which labor market institutions are responding to the needs of an increasingly female work force. But more than seven out of every 10 part-time jobs created since 1979 have been filled by people whose part-time status was involuntary. During the same period, the proportion of those who wish they could work more weeks over the course of the year also rose sharply.

Another explanation is the continued shift of the labor force out of higher-wage manufacturing into the lower-wage service sector. Manufacturing has not added a single new job to the economy since 1979. Virtually all the employment growth has been in services and trade — industries with twice the proportion of low-wage jobs as the manufacturing sector.

What would reverse the trend? Sustained economic growth would help — the rate of low-wage job creation did slow somewhat in 1985. But we are running out of time before the next recession, and even after four years of recovery the economy still lags far behind the pace of the high-wage job creation of the pre-1979 era.

Moreover, there seems little likelihood that the stagnation in manufacturing will change by itself, and no reason to believe that corporate managers will soon reverse the trends toward the creation of part-time work, two-tier wage contracts and subcontracting, or reduce their demands for wage concessions. In the absence of a new wave of labor organizing in services and of government policies to expand high-value-added production, wage standards for a substantial fraction of American working people likely will continue to erode. ■

Barry Bluestone and Bennett Harrison are professors of political economy at, respectively, the University of Massachusetts-Boston and the Massachusetts Institute of Technology. This article is based on their study for the Joint Economic Committee.

STATEMENT OF PHILLIP A. O'REILLY, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, HOUDAILLE INDUSTRIES, INC., ON BEHALF OF THE NATIONAL MACHINE TOOL BUILDERS' ASSOCIATION, FORT LAUDERDALE, FL, ACCOMPANIED BY JAMES H. MACK, PUBLIC AFFAIRS DIRECTOR, NATIONAL MACHINE TOOL BUILDERS ASSOCIATION

Mr. O'REILLY. Thank you, Mr. Chairman.

Good morning. My name is Phillip A. O'Reilly. I am Chairman and Chief Executive Officer of Houdaille Industries. With me today is James H. Mack, Public Affairs Director for the National Machine Tool Builders Association.

As you know, Mr. Chairman, Houdaille is all too familiar with the destructive impact brought by foreign export targeting. In 1982, Houdaille submitted a landmark petition to the President documenting the official creation of a Japanese machine tool cartel and the wide variety of financial and other assistance given the cartel by the Japanese Government.

Despite strong support for Houdaille's position from many in his Cabinet, and despite unanimous passage of a Senate resolution endorsing it, President Reagan turned us down—reportedly after the personal intercession of Prime Minister Nakasone. Houdaille was subsequently forced to close two plants and to sell two of its four remaining machine tool operations. Those actions resulted in the loss to Houdaille of approximately 2,200 jobs.

I remind the subcommittee that Houdaille filed its request under a then-untested provision of the Revenue Act of 1971 because there was no alternative provision under U.S. trade laws that offered a remedy to victims of foreign export targeting. Comprehensive trade reform legislation would, therefore, be incomplete without a provision which adequately addresses industrial targeting practices by foreign governments.

NMTBA is very pleased to see that S. 490 clearly defines and recognizes export targeting as an unfair policy or practice that may be actionable under U.S. trade laws.

We are pleased that, as currently drafted, S. 490 does not require that in order to be eligible for relief under Section 301, U.S. victims of foreign export targeting prove actual or threatened injury. In light of the exacting definition of targeting already set forth in S. 490, the evidentiary difficulties faced by any U.S. industry attempting to prove the existence of targeting and the predatory nature of the practices inevitably involved in a targeting plan, proof of injury should not be required.

Truly effective statutory remedies available to U.S. victims of industrial targeting must also take into account the fact that often the adverse competitive impact caused by targeting practices is not felt until after those practices have ceased. We must not permit targeting beneficiaries to continue to reap the unjust enrichment of past practices which facilitated their penetration into the U.S. market.

During last year's consideration of trade legislation, the House Ways and Means Committee adopted report language indicating that targeting, in order to be actionable under Section 301, must still be in existence at the time relief is requested. However, action under 301 would not be barred even though certain individual targeting practices may have ceased by the time the case is under investigation. This approach represents a reasonable and effective compromise, and we urge its inclusion in your committee's report to accompany S. 490.

We urge you to change S. 490 to provide that, once targeting has been proven, some form of adequate relief to U.S. victims should be mandatory. The availability of an assured remedy will provide a formidable deterrent to future targeting.

The heavy gun of retaliation is but one of the mandatory options that would be available to the President. There are a wide variety of other remedies that the administration could use to offset the unfair trade practice. This flexible approach would allow the Administration to take into account the fluctuating impact targeting has on various domestic industries. Thus, appropriate responses could be fashioned on an ad hoc basis under the mandatory action provision.

NMTBA also urges this committee to transfer to the United States Trade Representative responsibility for identifying and responding to unfair foreign targeting. Such a transfer would actually increase the Presidnet's flexibility, since geopolitical considerations would play a far less important role in trade decisions. Also, the President would retain ultimate authority through his power of appointment.

Our written testimony also comments on provisions in S. 490 which deal with protection of our national security and intellectual property.

Thank you, and we will be very happy to respond to your questions.

The CHAIRMAN. Thank you, Mr. O'Reilly.

Mr. Gabbert.

[Mr. O'Reilly's prepared statement follows:]

STATEMENT BY
PHILLIP A. O'REILLY
CHAIRMAN AND CHIEF EXECUTIVE OFFICER
HOUDAILLE INDUSTRIES, INC.
REPRESENTING THE
NATIONAL MACHINE TOOL BUILDERS' ASSOCIATION
BEFORE THE
COMMITTEE ON FINANCE
UNITED STATES SENATE
MARCH 17, 1987

I. INTRODUCTION

Good morning, my name is Phillip A. O'Reilly. I am Chairman and Chief Executive Officer of Houdaille Industries, Inc. of Fort Lauderdale, Florida. Houdaille is a diversified manufacturer of industrial products, including numerically controlled machine tools. I am appearing this morning on behalf of the National Machine Tool Builders' Association ("NMTBA"), of which Houdaille is a member. With me today is James H. Mack, NMTBA Public Affairs Director.

We appreciate this opportunity to discuss S. 490, the Omnibus Trade Act of 1987 -- legislation which proposes a fundamental restructuring of United States trade policy. We are aware that many members of this panel -- including you, Mr. Chairman -- share our long-standing concern regarding the unmistakable state of decline which currently characterizes U.S. industrial competitiveness. NMTBA believes that a vital machine tool industry -- the core of any nation's basic manufacturing capability -- can play a critical and unique role in restoring the United States to a leading position in world commerce.

Yet the future vitality of this and other basic manufacturing industries may very well be determined by the outcome of the "competitiveness" debate -- specifically, the degree to which potent and reliable statutory remedies will be available to domestic industries experiencing genuine competitive distress. Certainly we recognize that our present competitive problems are the product of complex economic and geopolitical dynamics. We are not suggesting, therefore, that trade reform legislation represents the panacea for struggling domestic industries. But we do believe that a major overhaul of U.S. trade law and policy is an essential prerequisite to any sustained improvement in this nation's competitive posture. Above all, U.S. industries need a climate which permits them to succeed -- something that is sorely lacking from many current trade policies and initiatives.

NMTBA therefore applauds your Committee's work as a timely recognition that the time has come for the adoption of meaningful revisions in U.S. trade laws. We would now like to address our remarks to specific portions of the bill which impact directly on the U.S. machine tool industry.

II. COMPREHENSIVE TRADE REFORM LEGISLATION

A. Industrial Targeting

NMTBA is very pleased to see that S. 490 clearly defines and recognizes export targeting as an unfair policy or practice that is actionable under Section 301 of the Trade Act of 1974. This recognition represents a substantial improvement over current law. Let me share with you why this is so.

As you know, Mr. Chairman, Houdaille is all too familiar with the destructive impact wrought by foreign export targeting. In 1982, Houdaille submitted a landmark petition to the President through the U.S. Trade Representative. For the first time the Administration was asked to examine the consequences in the United States of Japanese industrial targeting. Following literally man-years of persistent effort here and especially in Japan, we were able to document policies and practices employed by the government of Japan to skew world machine tool competition in favor of Japanese manufacturers.

The full details of the unfair Japanese trade and industrial targeting practices we uncovered can be found in our petition and in later submissions we made to the U.S. Trade Representative's office. Included are hundreds of pages of official government documents in Japanese, as well as English translations, describing the official creation of a Japanese machine tool cartel and the wide variety of financial and other assistance given the cartel by the Japanese government.

We found, for example, that as part of a highly coordinated plan, the Japanese government: impeded foreign competition in the Japanese machine tool market; directly financed machine tool industry research and development efforts (at one point, millions of R & D dollars were generated by wagering on bicycle and motorcycle races); granted highly concessionary loans and special tax benefits "outside" the regular tax code; and engaged in systematic market allocation. The long-range goal of selectively penetrating and dominating key export markets, such as the United States, remained the guiding principle. No one has ever challenged the veracity of those findings.

As a matter of fact, the U.S. Senate unanimously adopted a "Sense of the Senate Resolution" in December, 1982, urging the President to grant our Petition. Members of this Committee -- on both sides of the aisle -- were in the leadership of that effort.

However, despite strong support for Houdaille's position from many in his Cabinet and in the Congress, President Reagan -- in the wake of intensive lobbying by the Japanese government -- turned down our request that the (then available) investment tax credit be denied to purchases of unfairly subsidized machine tool imports. As a result of the President's failure to impose the requested relief, Houdaille was subsequently forced to close two plants and to sell two of its four remaining machine tool operations. Those actions resulted in the loss to Houdaille of approximately 2,200 jobs.

I remind the Committee that Houdaille filed its request under a then-untested provision of the Revenue Act of 1971. We chose to proceed under an obscure section of the tax code because there was no alternative provision under U.S. trade laws that offered a remedy to victims of foreign export targeting.

Comprehensive trade reform legislation would, therefore, be woefully incomplete without a provision which adequately addresses industrial targeting practices by foreign governments. As Houdaille's difficult experience illustrates, these practices pose severe competitive problems for U.S. companies, whose products may be excluded from protected home markets or unfairly displaced from third country markets and for U.S. firms who must compete here at home with unfairly subsidized imports. In addition, a serious threat to U.S. national security is posed when basic and defense-sensitive industries are, in effect, targeted out of existence.

NMTBA applauds the decision of the drafters of S. 490 not to require petitioners to prove material injury in targeting cases. In light of the exacting definition of targeting set forth in S. 490, the evidentiary difficulties faced by any U.S. industry attempting to prove the existence of targeting and the predatory nature of the practices inevitably involved in a targeting plan, proof of injury should not be required. Once targeting, as "measured" by the statutory definition, is found to exist, actual or impending injury to U.S. victims should, as the Bill recognizes in effect, be presumed.

As a matter of fact, in order for any relief to be granted under Section 301, there must be a showing of an adverse impact on U.S. commerce. Therefore, a specific injury test in targeting cases is redundant and unnecessarily burdensome to affected industries.

A specific injury test -- over and above that already implicitly contained in Section 301 -- would fail to adequately address export targeting programs which have not yet caused, or imminently threaten to cause, material injury to U.S. industries. By the time that such "statutory injury" can be documented, the industry may already have suffered irreparable competitive displacement. Thus, the burden of an injury requirement could well prove ineffective in preventing future Houdaille type cases from arising.

Truly effective statutory remedies available to U.S. victims of industrial targeting must also take into account the fact that often the adverse competitive impact caused by targeting practices is not felt until after those practices have ceased. We are aware that, traditionally, retaliation against unfair trade practices ends when the practices themselves end. But we must not permit targeting beneficiaries to continue to reap the unjust enrichment of past practices which facilitated their penetration into the U.S. market. For example, a foreign government may employ targeting practices in order to nurture the growth of one or more of its "infant" domestic industries. Most of the targeting may stop, however, once those industries reach a level of competitive maturity which permits them to then unfairly displace their American counterparts.

During last year's consideration of omnibus trade legislation, the House Ways and Means Committee adopted report language to accompany H.R. 4800 which provided that export targeting, in order to be actionable under Section 301, must still be in existence at the time relief is sought. However, the Report indicated that action under 301 would not be barred, even though certain individual targeting practices may have ceased by the time the case is under investigation. The Report also provided that, depending on the circumstances of the particular case, the effect of past practices may be considered in the determination of an appropriate remedy. NMTBA believes that this approach represents a reasonable and effective compromise and urges that similar language be included -- in the Senate bill itself or in the Report which accompanies the trade bill reported by this panel.

S. 490 does not require that any remedial actions be taken to offset or eliminate the effects of foreign targeting.

It is our view that if unfair foreign targeting is proven, Congress should require that mandatory action be taken by the President to offset or eliminate the effects of the targeting. The "heavy gun" of retaliation is but one of the mandatory options that would be available to the President. Other remedies could include the negotiation of orderly marketing agreements with offending governments, compensatory trade benefits to the affected industry, or administrative action geared toward restoring or improving the industry's international competitive position.

The flexibility inherent in this approach permits the President to take into account the fact that the nature and degree of the impact of targeting on or among various domestic industries will likely fluctuate. Consequently, appropriate remedies can be fashioned on an ad hoc basis under the "mandatory action" rubric.

It is imperative to indicate that unfair foreign targeting will not be tolerated and that if such targeting occurs, the executive branch will be required to take action.

We believe that mandatory action is truly the best way to provide deterrence against unfair foreign industrial targeting. If the Committee should disagree, the President should be held politically accountable, if he fails to strongly respond to proven unreasonable or discriminatory trade practices. S. 490 should -- at a minimum -- assure full public and Congressional scrutiny of the President's decision. If he chooses not to take remedial action in the face of proven unfair foreign targeting practices, the President should -- as a matter of law -- be required to provide Congress with a written explanation of the reasons for his failure to remedy unfair foreign practices, targeted at already ailing industries.

Finally, we would like to urge the members of this Committee to transfer to the United States Trade Representative responsibility for determining the existence of unfair foreign targeting and for ascertaining the appropriate response. Under current law, the President is often faced with direct pleas for non-action by foreign heads of state. That is exactly what happened in the Houdaille case. Relieving the President of the direct responsibility for identifying and enforcing Section 301 violations will make the process less subject to geo-political considerations. Transferring responsibility for assessing what should be done about unfair trade practices to the U.S.T.R. allows the President to directly remove himself from the uncomfortable position of personally taking action against our trading partners. At the same time, it allows the President to maintain some control through his power of appointment.

We wish to commend the Committee for your important work in the area of industrial targeting. It is only fair that real consequences should follow from a finding that foreign governments have acted unfairly to undermine American industry.

B. National Security Import Relief

NMTBA has, on several occasions, appeared before this Committee to discuss the machine tool industry's request for temporary import relief filed in March, 1983 under Section 232 (the National Security Clause) of the Trade Expansion Act of 1962. The history of the long and difficult process we encountered is widely known and need not be repeated today. However, we are pleased to report that, pursuant to negotiations authorized by President Reagan last May, the governments of Japan and Taiwan have agreed to limit certain machine tool exports[1] to the U.S. for a five-year period which began in January, 1987. NMTBA deeply appreciates the effort that many members of the Committee made on the industry's behalf throughout the prolonged pendency of the Petition. We know you were gratified to learn that, ultimately, those efforts paid off.

The President also asked Secretary Baldrige and Ambassador Yeutter to advise other countries that their machine tool exports to the U.S. should remain at levels which do not undermine the purpose of these voluntary restraint agreements. We understand that they have informed the principal foreign machine tool suppliers that the President is prepared to take unilateral action, under authority of Section 232, should this occur. In addition, the Department of Commerce has spearheaded a Domestic Action Plan to facilitate the industry's recovery effort.

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[1] Japan has agreed to limit its exports of machining centers, computer controlled and non-computer controlled lathes, computer controlled and non-computer controlled punching and shearing machines and milling machines. Taiwan has agreed to limit its exports of machining centers, computer controlled and non-computer controlled lathes and milling machines.

NMTBA recognizes that these actions are not intended to be a permanent solution to the industry's problems. We are hopeful, however, that they will provide a reasonable period of time -- and a climate -- in which the industry can take the necessary steps to improve its competitive position.

Our own experience with the 232 process, riddled with pitfalls and unforeseen delays, leads us to the conclusion that the imposition of deadlines on Presidential decision-making in future national security cases is warranted.

Our experience indicated no bottleneck in the Secretary's investigation of the Petition. He fully complied with the statute and, in fact, submitted his recommendations to the White House in advance of the one year deadline. We, therefore, believe that in light of the thorough evaluation which should precede any 232 decision, the current statutory limit of one year on the Commerce Department's investigation is reasonable and should be retained.

We did not encounter serious delays until the Petition was sent from the Commerce Department to the White House. The national security demands that these delays not be repeated in future cases. We, therefore, recommend that the Committee adopt the proposal, originally offered last year by Senators Byrd, Roth and Grassley, imposing a fairly short time limit in which the President must decide whether to accept his own Secretary of Commerce's recommendation to restrict imports that threaten to impair the national security.

C. Protection of U.S. Intellectual Property Rights

NMTBA commends the proposal to expand the list of unfair trade practices under Section 337 of the Tariff Act of 1930 to include the importation of any article formulated or manufactured by a process which infringes on a U.S. patent, trademark or copyright. We are also pleased to see that an injury requirement would no longer be imposed in such cases, nor would the industry seeking relief from unauthorized importation necessarily need to be "efficiently and economically operated" in order to obtain relief. The proposal aptly recognizes that the primary focus of inquiry in such cases should simply concern whether or not infringing importation has occurred. NMTBA believes that, by strengthening the protection of U.S. intellectual property rights, these amendments to Section 337 will enhance the competitiveness of U.S. companies competing in world markets.

III. CONCLUSION

United States' competitiveness and national security are unquestionably intertwined. We, as a nation, simply cannot afford to sit back and watch our most critical industries be targeted out of existence under the guise of "free trade." Yet, that is the inevitable outcome unless Congress acts to strengthen U.S. trade laws by providing prompt and certain relief to U.S. victims of foreign export targeting and by imposing reasonable deadlines on Presidential decision-making in national security import relief cases. We look forward to working with you to achieve these objectives.

STATEMENT OF J. STEPHEN GABBERT, EXECUTIVE VICE PRESIDENT, RICE MILLERS' ASSOCIATION, ARLINGTON, VA, ACCOMPANIED BY BART FISHER, COUNSEL, RICE MILLERS' ASSOCIATION, WASHINGTON, DC

Mr. **Gabbert**. Thank you, Mr. Chairman.

We appreciate the invitation to appear before the committee to share our thoughts regarding revision of Section 301. I will summarize my remarks and request that my entire statement be placed in the record.

The **Chairman**. That will be true for each of the witnesses. The entire statement will be put in the record.

Mr. **Gabbert**. Mr. Chairman, members of the Rice Millers' Association and its associate members account for virtually all U.S. rice that is exported from the United States. We probably have had more experience with Section 301 than any other agricultural group, having filed three Section 301 complaints—one against Japan in 1980, another one against Taiwan in 1984, and the most recent one, which has been referred to in the context of the hearings, against Japan in 1986.

We believe that the 301 statute must be amended if the rice industry is going to successfully be able to penetrate foreign markets.

Since implementation of the 1985 Farm Act and its rice marketing loan provisions contained therein, our export picture has dramatically improved. We have essentially become price competitive and have been able to recapture new markets; however, the problem we face is penetrating new ones, especially those where we are facing what we consider to be illegal trade barriers. Without some assistance in removing these trade barriers, we find ourselves in a very difficult situation where our price competitiveness and quality become essentially irrelevant.

Mr. Chairman, Japan maintains some of the most blatantly discriminatory and illegal trade barriers that we face. We value the available rice market in Japan, that if we were to access that part of it, it would be worth approximately $1[illegible] billion—$1.7 billion to the United States rice industry.

In an effort to open that market, as I mentioned earlier, we filed a Section 301 complaint last year in September. Notwithstanding the Administration's own admission that Japan's zero import quota for rice imports is a direct violation of the GATT, the Administration chose not to pursue the matter in the context of 301 and to refer it to the multilateral trade negotiations area. There are several observations we would like to make about that.

One, Mr. Chairman, is that we felt the Administration was holding aces in a case that they clearly admitted was illegal. We think that it looked the Japanese in the eyes, while holding aces, blinked, and folded its cards and walked away. The 301 interagency committee never met. As far as we know there was no EPC meeting on the case. It was essentially decided at some very high levels of government.

Two we believe that Ambassador Yeutter needs new tools to confront illegal foreign trade barriers such as those we encountered in Japan. We hope that the committee will support passage of S. 500, recently introduced by Senator Pryor, which we think will go a long way in helping to address some of the problems that we are facing.

Also, Mr. Chairman, we are working with staff members at the present time to introduce specific legislation regarding 301, hopefully making it available within the next several weeks.

Mr. Chairman, we appreciate this opportunity to testify. We will be happy to answer any questions that the committee may have.

The CHAIRMAN. Thank you, Mr. Gabbert.

Ms. Haggart, if you would proceed.

[Mr. Gabbert's prepared testimony follows:]

STATEMENT

OF

MR. J. STEPHEN GABBERT

EXECUTIVE VICE PRESIDENT

THE RICE MILLERS' ASSOCIATION

ON

COMPREHENSIVE TRADE LEGISLATION

AND

REFORM OF SECTION 301 OF THE TRADE ACT OF 1974

BEFORE

THE COMMITTEE ON FINANCE

U.S. SENATE

March 17, 1987

Mr. Chairman and Members of the Committee,

My name is Stephen Gabbert. I am Executive Vice President of The Rice Millers' Association (RMA), national trade association of the United States rice milling industry. I am accompanied by our counsel, Bart S. Fisher, Esq., of the Washington law firm of Patton, Boggs & Blow. RMA members consist of farmer-owned cooperatives and independently-owned rice milling companies located in Arkansas, California, Florida, Louisiana, Mississippi, and Texas. Farmers who own our cooperative members produce approximately 65 percent of the rice in the United States. Our members account for virtually all of the rice milled in the United States. In addition, there are 25 associate members of RMA, including major U.S. exporters of rice. Together, RMA members and associate members account for virtually all U.S. rice exports.

Like Members of this Committee, we have a vital interest in the formulation of our trade policy, particularly as it affects agricultural exports. We appreciate your invitation to share our thoughts as you consider revisions to section 301 of the Trade Act of 1974 and continue your efforts to develop trade legislation responsive to the needs of U.S. exporters. We have probably had more experience than any other agriculture group in using section 301 to combat unfair foreign trade practices. In two instances we accomplished our objectives, but in our most recent effort we were stymied because the Act as written would have required our case to be referred to the GATT for resolution.

Mr. Chairman, before discussing our specific concerns about section 301 and our proposed amendment to it, we want to give you an idea about how important rice exports are to the U.S. rice industry. International rice production and trade in rice is highly politicized. More than 50% of international trade is accounted for by government agencies. This, in part, explains why rice is often described as the "diplomatic crop."

The United States must export about 60% of its rice production into a highly protected environment. Many countries restrict importation of rice. Nearly prohibitive tariff and nontariff import barriers have created serious impediments to international trade in rice. U.S. rice exports have declined precipitously since 1981, when they accounted for 23 percent of world rice exports. In fact, between 1981 and 1985, rice exports fell from a high of 3.0 million metric tons to 1.9 million metric tons. Import barriers by such countries as Japan, Korea, Nigeria, and the European Community contributed to the decline of U.S. global market share and stagnation in growth of the international market. The high dollar and the U.S. price support system also played a role in the decline in exports as our rice became less price competitive.

Since implementation of the rice marketing loan program mandated by the Food Security Act of 1985, our export picture has dramatically improved. U.S. rice export sales for the 1986/87 marketing year are running about 62 percent ahead of last year. As a result of the rice marketing loan provisions of the Act, U.S. rice is now price competitive with rice from other countries. In addition to making U.S. rice competitive in the international marketplace and expanding domestic demand, the rice marketing loan program has stimulated local farm economies, moved the rice crop into private commercial channels instead of into government stockpiles through loan forfeitures, and provided the rice industry with a solid basis for an orderly transition from government reliance to market dependence. To the Administration's credit, the rice marketing loan program has been administered and managed reasonably well.

While the rice marketing loan program facilitates recapturing lost markets and penetrating new ones, it cannot surmount illegal import barriers. Without access to foreign markets, price, quality, and competitiveness are irrelevant.

Among the most blatantly discriminatory and illegal trade barriers that the U.S. rice industry faces today are Japanese rice import restrictions. This market could be worth up to $1.7 billion to the U.S. rice industry, but is presently closed. Since 1961, Japan has increasingly protected its pampered rice farmers through what has become a virtual ban on rice imports. While U.S farmers have become more efficient and begun the transition from government to market dependence, Japanese rice farmers benefit from complete import protection and a guaranteed price for rice ten times the world price that has allowed them to prosper at the expense of the rest of the country. The Japanese economy, supposedly the paragon of efficiency and productivity, is being held hostage by its highly protected and inefficient agricultural sector.

Japan's "closed door" policy has been particularly burdensome to California rice growers, who produce the type and quality of rice grown and consumed in Japan. Japanese consumers have become increasingly interested in purchasing United States rice, not only because of its high quality and flavor, but also because of its low price. Despite this, Japan has steadfastly pursued its protectionist policy, leaving Japanese consumers and U.S. rice farmers to pay the price. The bloated Japanese price for rice has removed up to $25 billion in purchasing power from the Japanese economy, a figure equal to almost half the U.S. trade deficit with Japan in 1986.

In an effort to open the restricted Japanese market, we filed a section 301 petition with the U.S. Trade Representative on September 10, 1986. As Members of the Committee know, section 301 of the Trade Act of 1974 is perhaps the most powerful of the statutory mechanisms available to the President--when used--to open up closed markets.

Notwithstanding the unassailable fact that Japan continues to violate its international obligations by effectively precluding imports of rice, the Administration nonetheless chose not to exercise the authority delegated by Congress to pursue this matter on a bilateral basis with the Japanese or to undertake unilateral action against Japan. It did this even though it conceded that our section 301 petition could not have had a firmer legal basis.

Mr. Chairman, we do not believe that our export potential will be realized unless Congress provides further tools and guidance to the Administration. We support legislation that will encourage other nations to open their markets to U.S. rice exports. On February 5, 1987, Senator Pryor introduced S. 500, the "Rice Equity and Export Expansion Act of 1987." We believe this trade legislation could easily serve as a model for other agricultural commodities.

The bill is modelled on the telecommunications bill reported favorably by this Committee last year. The bill provides that, within 6 months after date of enactment, the U.S. Trade Representative (USTR) is required to identify those foreign acts, policies, and practices of no less than 15 countries which are the largest potential rice markets that deny fully competitive market opportunities to the U.S. rice industry. Then the USTR must establish specific negotiating objectives for each country identified, drawing from a list of primary and secondary negotiating objectives set forth in the bill.

Immediately thereafter, the President is required to begin negotiations with countries identified by the USTR as denying fully competitive market opportunities. The purpose of these negotiations is to enter into bilateral or multilateral agreements which achieve the primary and secondary objectives established by the USTR for each country. Such agreements must be reached within 12 months of the date of enactment. However, if substantial progress is being made, the President may request up to two 6-month extensions of negotiating authority, subject to "fast-track" Congressional review (an up-or-down vote within 45 days, with no amendments permitted).

If the President is unable to enter into a satisfactory agreement with a particular country within the authorized time period, the President is required to take whatever actions authorized in the bill are necessary and appropriate to achieve his primary negotiating objectives. The President, at his discretion, also may take whatever authorized actions are necessary to achieve the secondary objectives not covered by an agreement.

The USTR must conduct annual reviews of agreements reached by the President to determine whether any act, policy, or practice of the country concerned is not in compliance with terms of the agreement or otherwise denies fully competitive market opportunities. If he finds a violation or that these opportunities are being denied, he must take whatever actions are authorized to fully offset the foreign acts, policies, and practices and to restore the balance of concessions between the United States and the foreign country.

The legislation also establishes two broad negotiating objectives for the Uruguay Round of Multilateral Trade Negotiations. The first objective is identical to section 152(b)(8) of the House omnibus trade bill. The second objective codifies the intent of title I of the bill, namely, to encourage elimination of tariff and nontariff barriers to internatinal trade in rice.

Finally, the bill amends section 303 of the Trade Act of 1974 to provide the USTR with discretion to refer section 301 complaints to the GATT for resolution in cases involving agricultural products. As modified, section 303 would not require anything new of the USTR. Rather, it would provide him with the discretion to pursue agricultural cases, bilaterally or unilaterally, without being required to refer them to the multilateral dispute resolution process of the GATT for its interminable review. Because the GATT appears incapable of resolving disputes of this nature in a timely fashion, we think the law ought not require the USTR to burden U.S. exporters with this additional delay in reducing barriers to trade.

Mr. Chairman, many questions have been raised in the Congress about the reasoning of Ambassador Yeutter in rejecting our section 301 petition. The problem lies not in section 301 of the Act, but in section 303, which reads in relevant part:

> If the [section 301] case involves a trade agreement and a mutually acceptable resolution is not reached during the consultation period, if any, specified in the trade agreement, the [USTR] shall promptly request proceedings on the matter under the formal dispute settlement procedures provided under such agreement.

19 U.S.C. § 2413(a) (emphasis added).

Thus, with regard to any agricultural issue involving the articles of the GATT, the USTR is currently obligated to turn the issue over to the GATT dispute-resolution process. In formally rejecting our petition, Ambassador Yeutter stated that, if he were to accept our section 301 complaint, he would have to turn the whole matter over to a GATT panel. In his view, "[t]his is unlikely to precipitate market-opening changes in the Japanese rice program, which is the petitioners' objective." In other words, if pursued, the GATT route on the Japan rice access issue would have yielded a Pyrrhic victory. Unfortunately, under current law Ambassador Yeutter was forced to protect the lawbreaker by rejecting our section 301 petition.

Congress should give Ambassador Yeutter the tools he needs to break down foreign barriers to U.S agricultural exports. As we indicated above, we think this can be accomplished if the USTR has the discretion to refer agricultural-related trade issues to the GATT when appropriate. This discretion will provide the USTR with the leverage needed to force countries such as Japan to deal with the United States rather than to delay and to block all effective remedial action.

We believe that your delegation of authority to the President to improve GATT dispute resolution procedures in the Uruguay Round would be crippled unless it is accompanied by our suggested amendment to section 303. At present, agricultural dispute resolution in the GATT is a joke. As recent agricultural cases demonstrate, disputes in the GATT take too long to address and are overly politicized by member countries. Even when decisions are finally reached, they may be ignored by the affected parties.

Three examples in the agricultural products area should suffice to make the point that "dispute resolution" in the GATT is an oxymoron. In 1976, at the request of the Florida Citrus

Commission, the United States challenged the European Community's preferential import duties on citrus fruits from certain Mediterranian countries. This matter remains unresolved, 11 years later. Similarly, the Millers' National Federation case involving alleged violations of the Community's wheat export subsidies, which was commenced in 1975, also remains unresolved, 12 years later. Finally, in 1986 a GATT panel ruling against the Community for its alleged violation of the GATT through its grouping of production subsidies on canned peaches, canned pears, and raisins was reversed. In this case, which has been going on since 1981, the Community managed to have the GATT reverse its decision because it did not like the panel's determination.

We do not wish to have the rice industry and other agricultural groups fall into the same "black hole" at the GATT that has already enveloped the citrus, wheat, and raisin industries. We urge you to strengthen the hand of the USTR in dealing with illegal foreign trade barriers confronting U.S agricultural exporters, while also strengthing the GATT dispute resolution process.

Mr. Chairman, we are sure the Government of Japan will be closely watching the trade legislation process as it gauges whether or not to let U.S rice enter its country. We hope you and your colleagues on the Finance Committee will send a strong signal to Japan and other import-limiting countries by giving favorable consideration to the Rice Equity and Export Expansion Act of 1987 during markup. We appreciate your past efforts to assist U.S. exporters and hope you can continue to help them reach their full export potential.

Thank you again for this opportunity to testify.

STATEMENT OF VERONICA HAGGART, VICE PRESIDENT OF INTERNATIONAL TRADE, MOTOROLA, INC., ON BEHALF OF THE SEMICONDUCTOR INDUSTRY ASSOCIATION, WASHINGTON, DC

Ms. HAGGART. Thank you, Mr. Chairman.

As you and the members of this Committee know, the Semiconductor Industry Association brought a Section 301 case against Japan in 1985. A comprehensive settlement agreement was negotiated this past August which was hailed by the U.S. industry as holding out the opportunity for significant relief for the industry's trade problems, if properly implemented and enforced.

Leaving aside for the moment the critical issue of enforcement of the agreement which was highlighted a few moments earlier by Senator Heinz, based on the negotiated settlement achieved by our tireless and talented negotiators, one could conclude that Section 301 has in certain circumstances been an effective tool for addressing a complex, multifaceted trade problem such as that confronted by our industry.

In cases such as ours where access to a closed foreign market is an issue, Section 301 is the only trade remedy available. In addition, in our case it proved to be a broad enough remedy to also permit the fashioning of a mechanism to comprehensively detect and hopefully deter future dumping in semiconductor products not previously the subject of individual dumping cases—again, if properly implemented and enforced.

At the same time, Mr. Chairman, the case also revealed certain weaknesses in the Section 301 process, and S. 490, introduced by you and others of your colleagues, clearly recognizes some of these.

Although SIA has not taken a formal position on all of the current legislative proposals dealing with reform of Section 301, our experience with the semiconductor case should be instructive to this Committee as it proceeds to consider how to make Section 301 a more effective trade remedy law.

Briefly summarized, issues raised by our case include the following:

First, the semiconductor case was a targeting case; the issue of targeting has just been very effectively covered by Mr. O'Reilly so I will be very brief. Although the Administration did ultimately find our case to be actionable, serious questions were raised along the way as to whether a targeting case would be covered by Section 301. S. 490 does make it clear that foreign industrial targeting programs should be actionable, and the need for standards such as those enunciated in the bill are clearly needed.

Speaking personally, my company also views it as key that high tech industries such as ours be further assured of an appropriate response by our government where foreign targeting programs have been found to injure a U.S. industry.

Second, the experience of the semiconductor case shows that the Section 301 process as currently constituted is a highly politicized one. The current interagency process, in my view, often tends to dilute the negotiating leverage and ultimate effectiveness of any relief that might be granted, as trade priorities may be easily subordinated to non-trade considerations.

While other agencies in the process may offer valuable input and advice to an ultimate solution, consideration of transfer of ultimate Section 301 decisionmaking authority from the President to the U.S. Trade Representative could help to ameliorate these problems. Just as with countervailing duty and antidumping cases, one individual would then be held accountable.

Finally, and perhaps for SIA the most critical issue today, the timing of this hearing could not have been better to allow me to emphasize the importance of adequate enforcement measures once a settlement agreement has been reached. To the best of my knowledge, information collected today has in fact demonstrated that dumping of semiconductors, particularly in third countries, persists over seven months after the agreement was signed. Further, no steady measurable progress with respect to market access has been achieved as promised.

It is critical that the Administration decide immediately—and Alan Holmer responded that we would soon be reaching the flashpoint on this—what enforcement measures it will take.

This Committee's support for a resolution calling for imposition of sanctions against Japan for breaching the semiconductor agreement will add significant support to effective enforcement of the semiconductor agreement.

For the longer term, your consideration of additional legislative provisions designed to ensure more vigorous enforcement of Section 301 settlement agreements is to be commended.

In conclusion, Mr. Chairman, the semiconductor agreement was a landmark agreement. A case could be made that the industry was lucky—the timing of the case turned out to be propitious, and the political environment conducive to a favorable agreement. As previously indicated, our negotiators were determined and persistent. Additionally, the leverage provided by the nearly concurrent filing of three dumping cases, and the rigorous pursuit of those cases by the Department of Commerce, was unique to this case. They provided a very important added dimension not present in previous Section 301 cases and not likely to be often duplicated again.

The CHAIRMAN. Thank you very much, Ms. Haggart.

Mr. Morris.

[Ms. Haggart's prepared testimony follows:]

BEFORE THE
COMMITTEE ON FINANCE
UNITED STATES SENATE
WASHINGTON, D.C.

Testimony of
VERONICA A. HAGGART
on behalf of the
SEMICONDUCTOR INDUSTRY ASSOCIATION

March 17, 1987

Mr. Chairman, I am Veronica A. Haggart, Vice President and Director, International Trade Relations of Motorola, Inc. I am appearing on behalf of the Semiconductor Industry Association (SIA) which represents over 50 U.S.-based manufacturers of semiconductors, accounting for about 90% of U.S. production of semiconductors. I am pleased to have this opportunity to appear before you today.

In 1985, SIA filed a Section 301 action against Japan in semiconductors, in what proved to be the largest Section 301 action ever handled by USTR. This case culminated in an Agreement with Japan in August 1986 which, by its terms, was highly favorable to the U.S. industry and a landmark in U.S. trade law. While SIA has not taken a position on the specific provisions of the trade bills currently before the Congress involving Section 301, I believe the semiconductor case revealed a number of the strengths and weaknesses of the current Section 301 process, and therefore may be instructive to this Committee.

SIA's Section 301 Action

As you know, the basis for SIA's Section 301 petition was a series of actions by the Japanese government which were designed to "elevate" the Japanese semiconductor industry to a position of world leadership -- an example of the phenomenon commonly referred to as "targeting". The policies at issue were a combination of home market protection, subsidies, and *de facto* antitrust exemptions. The

Japanese semiconductor market was formally protected by government measures until 1975. The removal of formal barriers was accompanied by what the Japanese called "liberalization countermeasures," that is, government policy measures designed to offset the impact of liberalisation and create a market structure which would prevent substantial foreign penetration. As a result, the U.S. share of Japanese sales is actually lower today than it was when the market was protected by formal measures. The Japanese semiconductor industry also received substantial financial assistance from the government, and was exempt from scrutiny under the Antimonopoly Law. Within this policy framework, Japanese producers demonstrated a repeated propensity to expand capacity much more rapidly than any reasonable projection of demand would justify -- a dynamic that culminated in massive Japanese dumping in the 1980s. In SIA's view, these Japanese actions violated a series of commitments and agreements entered into by Japan with the U.S., most recently a 1983 accord on semiconductor trade developed by the U.S.-Japan High Tech Working Group.

The Advantages of Section 301

SIA resorted to a Section 301 action because Section 301 was the only statutory remedy available to the U.S. industry to address this particular combination of foreign practices. No other trade remedies are available in situations involving denial of access to a foreign market, and

Section 301 is the only mechanism a U.S. industry can invoke when its rights are being denied under an international accord or agreement.

Section 301 also offers at least the prospect of a remedy which is designed to address the basic problems confronted by a U.S. industry. In our case, the remedial authority available to the President under Section 301 permitted the fashioning of a comprehensive agreement to address the problems of market access and dumping. If implemented effectively, the agreement can forestall the need for additional litigation and will address some of the underlying causes of U.S.-Japanese friction in this industry. For example, while individual antidumping actions might ameliorate the effects of dumping in a single product area, Section 301 made possible the development of a mechanism intended to detect and deter dumping throughout the entire sector if fully implemented.

Weaknesses of Section 301

Unfortunately, SIA's Section 301 action also revealed a number of the shortcomings and weaknesses of Section 301. To begin with, the President, not the U.S. Trade Representative, is the final decisionmaker in every Section 301 case. As a result, every decision under the statute becomes highly political and involves numerous non-trade considerations. At present, each Section 301 action must be reviewed by an interagency group, with USTR functioning primarily as a committee chairman. If this interagency group is divided over the issue of granting relief -- and it usually is -- the chances are strong that no relief, or at best inadequate relief, will be granted. The foreign parties involved are often skillful at exploiting this cumbersome structure to their advantage, probing the U.S. government to find constituencies which favor taking no action in a given instance. Ultimately, this dynamic tends to undercut USTR's ability to negotiate effectively.

In the SIA case, it is a tribute to the current U.S. Trade Representative, Clayton Yeutter, that the weaknesses inherent in the interagency review process did not prevent the negotiation of an effective settlement. However, because of the nexus between microelectronics and national security, factors existed in this case which may not exist in other cases -- and even in semiconductors, where an unusual degree of unanimity existed within the government, the interagency process was always at least a potential impediment to a satisfactory outcome.

A closely related problem under Section 301 is the fact that the President is reluctant to make a formal determination that another country has acted unfairly, even in meritorious cases. In the semiconductor case, Japanese representatives argued that any Presidential determination of unfairness would be viewed by Japan as tantamount to a national insult, which could have unpredictable consequences. Such arguments are common in Section 301 actions and inevitably affect the interagency review process, since a number of U.S. agencies often regard maintaining relations with trading partners and allies as a more important priority than the granting of sectoral trade relief.

While SIA has not taken a formal position on the subject, one way to ameliorate these problems would be to transfer Section 301 authority from the President to USTR. This would simultaneously de-politicize Section 301 cases and remove them from the interagency process. Section 301 cases could be administered in a manner similar to the antidumping and countervailing duty laws, with the grant of relief becoming more common and less visible, and with less intrusion of non-trade related considerations. At the same time, the USTR's ability to negotiate a favorable resolution of Section 301 actions would be enhanced by the fact that he would possess the ability, where necessary, to impose retaliatory measures. In addition, a requirement that there be a finding of unfairness would also facilitate a more meaningful resolution in meritorious cases.

The Need for Clearer Standards

Another weakness of Section 301 is its lack of clearly articulated standards as to what kinds of foreign conduct are actionable under the statute. This need is particularly acute in high technology industries, characterized by rapid change -- in order to plan our investment decisions, we need some assurance that the U.S. Government will come to our assistance when we confront certain types of unfair foreign conduct. For example, in our case, SIA argued that the Japanese government had helped to create, and was now tolerating, a market structure characterized by cartel-type behavior that restricted U.S. sales in Japan; an initial rejoinder was that this type of conduct was not actionable under Section 301. SIA pointed out that Japan had breached commitments made in the 1983 U.S.-Japan accord on semiconductors; an initial response was that these accords were not a formal agreement and were thus not actionable under Section 301. SIA cited Japanese "targeting" of the semiconductor industry; again, the initial response was that targeting is not actionable under Section 301. While these responses did not prevail, the fact that they were raised at all illustrates some of the problems faced by a petitioner.

The basic problem is that Section 301 offers little guidance as to the scope of foreign conduct embraced by the terms "unreasonable," "unjustifiable," and "discriminatory." The Administration must weigh the facts of each case against amorphous concepts of fairness drawn from economic theory, other U.S. trade laws, and various international agreements. Section 301 may apply to a foreign targeting program in its entirety, for example, or may not apply at all, depending on the viewpoint of a given Administration at a particular point in time. The interagency review process involves agencies and departments with widely divergent views of what constitutes unfairness -- a fact which can produce administrative paralysis, even in meritorious cases.

The obvious remedy for this problem is a clearer statutory articulation of the types of conduct which are actionable under Section 301. Clearly, foreign industrial targeting programs that injure U.S. industries should be actionable, a fact which should be clarified in the statute itself. S.490 would make this clarification, defining "export targeting" as an "unreasonable" practice for purposes of Section 301.

The Need to Enforce the Semiconductor Agreement

Finally, I would like to add a postscript to my discussion of SIA's Section 301 action. As I noted, the SIA case culminated in a favorable agreement with Japan regarding market access and dumping in August of 1986. Unfortunately, Japan has been in breach of that agreement virtually from the day it was signed, and remains in breach today, over seven months since the agreement was concluded. Japan has shown no sign of movement on its commitment to improve U.S. market access, and Japanese firms continue to dump semiconductors today. The Administration must decide very soon what actions it will take to sustain the Agreeement in light of Japan's repeated and systematic violations, both with respect to market access and dumping.

Even a very favorable agreement -- such as this one -- is of little value if one of the parties to the agreement can ignore its terms with impunity. Indeed, it was Japan's flouting of a prior agreement -- the 1983 semiconductor accords -- that led to SIA's filing of a Section 301 action in the first place. This Committee recently considered a resolution calling for the Administration to impose sanctions against Japan for its breaches of the current Semiconductor Agreement. Favorable action on this joint resolution will add significant support to the Administration's efforts to enforce the Agreement.

In addition, S.490 contains provisions designed to ensure more vigorous enforcement of settlement agreements negotiated pursuant to Section 301. In my view, the problems encountered with respect to implementation of the current Semiconductor Agreement underscore the need for consideration of this type of legislation.

Finally, I note that S.490 raises the whole issue of "adversarial" trade, and in particular, the problems posed by Japan's trade policies. This issue is one of the most important economic problems confronting our country today, and I commend you for highlighting it in the current legislation.

Conclusion

SIA's Section 301 action has shown the statute's potential as a mechanism for addressing a complex and multifaceted trade problem in a comprehensive manner. The 1986 Semiconductor Agreement was a landmark achievement. At the same time, SIA's experience in the Section 301 investigation revealed some important shortcomings in the current law. I commend you for the interest you have shown in this issue, and look forward to working with you to make the improvements which are needed in this key trade remedy.

STATEMENT OF JULIAN C. MORRIS, PRESIDENT, AUTOMOTIVE PARTS AND ACCESSORIES ASSOCIATION, LANHAM, MD, ACCOMPANIED BY F. LEE KADRICH, DIRECTOR, GOVERNMENT AFFAIRS AND TRADE, APAA

Mr. MORRIS. Thank you Mr. Chairman, members of the committee.

I asked my associate Mr. Lee Kadrich to accompany me this morning, to enable me to better answer any questions you may have.

As we discussed, our industry's survival hinges on American success in prying open Japanese parts markets. Round IV of the high level auto parts MOSS trade negotiations has just recently concluded. Unless MOSS succeeds in breaking through the shell around Japanese original equipment manufacturer (OEM) supplier families that keeps us out, we face the wholesale export of industry profits, jobs, and technology to Japan. In my full testimony, I have described in great and gory detail the transition in our industry occasioned by these events.

Concerning the crucial MOSS talks, our association offers the following observations:

The U.S. should press for Japanese reinstatement of the principles of the 1980 agreement to make significantly greater U.S. auto parts purchases. The problems of closed original equipment and replacement parts markets are just as valid today; an agenda for remedial action as timely.

The U.S. should insist on Japan's achieving our two top objectives, applicable wherever Japan builds and sells cars: (1) removal of structural impediments to original equipment sales, and (2) access to the global aftermarket for Japanese cars.

(2) Since private and not government barriers are at issue, U.S. sales targets and timetables are vital. Regardless of how we set the benchmarks, reciprocal market access must be the ultimate objective. While they enjoy a lion's share of our open market, we have only one percent of theirs. Monitoring of Japanese purchases of our goods should continue until significant and continuous volume increases are assured.

(3) Moves by transplanted OEM's to encourage relocation of their supplier families could shut the door permanently on American parts sales. They are not market opening gestures. U.S. discouragement of further investment should be the corollary to our top objective of OE market access. The migration could be averted if transplanted OEM's show good faith by turning to existing American sources. Independent studies show and Japan's OEM's know that there are highly competitive U.S. manufacturers in every automotive product category.

The U.S. market is as open as theirs is closed. APAA urges nonprotectionist steps to end government subsidization of foreign automotive suppliers.

(1) Congressional push may be needed to put the federal house in order on the Japanese supplier investment issue. Market facts should convince federal and state leaders that, by encouraging new capacity to serve a flat market, they are helping foreign firms displace the market share of existing firms. If the states persist, legis-

lation should be considered at least to ban the use of federal funds for such purposes.

(2) Hold the line on new Foreign Trade Zone (FTZ) subzone grants for auto making, until we can see whether they serve the public interest. Japanese OEM transplants and their home suppliers now benefit the most from subsidized parts imports. We would urge congressional consideration of legislation that: (a) sets a strict public interest standard in terms of the national economic interests, and (b) subjects subzone applications to the Administrative Procedures Act.

(3) The Auto Pact's duty-free OE shipments provision between Canada and the United States is being abused by unintended third-party beneficiaries, particularly Japan, and demands our reevaluation. Any removal of aftermarket tariffs without first clearing away Canadian domestic content/production rules and duty remission schemes would invite a duty-free blitz on our huge $100 billion aftermarket. We urge the creation of safeguards to prevent foreign-owned suppliers from making either nation the base for a wholesale duty-free launch on the other market.

As Commerce Undersecretary Bruce Smart has so aptly stated, Japanese OEM's who benefit the most from open U.S. markets could lose the most, unless the Congress is satisfied that parts markets are opening and that there are bottom line measurable results. Access to the huge U.S. marketplace offers the ultimate leverage.

We look forward to working with this committee to shape legislation that uses that lever to pry open other markets.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Mr. Morris.

Mr. Ronzoni.

[Mr. Morris' prepared testimony follows:]

STATEMENT OF

JULIAN C. MORRIS

PRESIDENT

FOR THE

AUTOMOTIVE PARTS AND ACCESSORIES ASSOCIATION, INC.

PRESENTED TO

THE COMMITTEE ON FINANCE

UNITED STATES SENATE

MARCH 17, 1987

Mr. Chairman and Members of the Committee:

I am Julian C. Morris, president of the Automotive Parts and Accessories Association (APAA). Thank you for this opportunity to discuss our parts industry's trade concerns. Moreover, I will propose legislative options that could specifically challenge parts trade injustices and enhance U.S. auto parts industry competitiveness. For the Committee's review and use, I have attached appendices discussing the scope and nature of our industry's trade problems and APAA policy recommendations.

As the representative of nearly 1,000 American automotive product suppliers, APAA knows that even the most competitive suppliers are threatened by trade distorting practices of foreign governments and businesses that block the use of U.S. parts in building and servicing the foreign-made cars that now dominate many third markets and continue to increase their penetration of the U.S. market.

As a founding member of the pan-industry Automotive Products Export Council (APEC), we have worked long and hard with four other major automotive component trade associations to build American parts export opportunities in all markets where cars are built and sold.

Nowhere is this more important than with Japan, the car builders for the world. As we discuss here how our industry's survival hinges on American success in prying open Japanese parts markets, Round IV of the high-level auto parts MOSS trade negotiations has just recently concluded. Unless MOSS succeeds in breaking through the shell around Japanese auto maker/supplier families that keeps us out, we face the wholesale export of industry profits, jobs and technology to Japan.

Japanese auto makers, or Original Equipment Manufacturers (OEM's), could control 50 percent of the content of all cars sold in America by 1988, through imports, transplanted production, joint venture "hybrids," and more Japanese parts under the hoods of remaining Big Three output.

If allowed to compete, American Original Equipment (OE) producers could develop new Japanese customers to supplant traditional Detroit contracts. The same holds true in the world's emerging auto markets, where a host of domestic content rules, export performance requirements and other barriers block U.S. parts sales. I will recommend policies that APAA believes are essential to see that U.S. suppliers get their fair share of the global auto industry.

APAA And Its Members

APAA is a trade association headquartered in the Washington, D.C. metropolitan area. Our association represents 1,000 manufacturers producing parts, accessories, tools, equipment and supplies for consumption in the OEM and consumer markets. It is the consumer replacement parts markets, the aftermarket, where our industry makes its greatest profits and where most of our members' products are sold. We have another 900 members engaged in selling, as members of the distribution chain, manufacturers' representatives, wholesalers, distributors, export management companies, and retailers.

The aftermarket's financial health means more to America's economic well-being than even that of the OEM's. Not only do we have more companies -- some 40,000 firms engaged in automotive supply -- but we also have double the employment of the OEM's and their dealers.

The aftermarket is vital to the nation's output, employment, exports, and defense capabilities. Yes, Mr. Chairman, we are talking about jobs and the ability to defend ourselves, remembering that during past wars the U.S. automotive industry truly was the arsenal of democracy.

How The Aftermarket Works

Let me explain briefly how our industry works. In America, cooperation between suppliers and OEM's is marked by several characteristics. OEM's provide early product design information to the supplier and order a base volume of production. Suppliers produce not only for the auto makers but also for aftermarket distribution in dealer networks and independent outlets, a factor that keeps costs low and consumer prices very competitive.

As a car ages the aftermarket assumes the service load from new car dealerships. Once new car warranties expire it is the independent aftermarket that provides nearly all of the service on these cars. The aftermarket also gives consumers a variety of choices in service facilities and sales outlets for do-it-yourselfers.

Parts made for OEM's are saleable worldwide, a factor that helps the U.S. trade balance. Of course, a number of parts do not require an OEM/supplier relationship, e.g., chemicals and accessories. Americans already compete vigorously in the market for fast moving products, parts that do not require specialized tooling or development costs for producers that already make similar products for domestic application.

Japan's Assault on America's Parts Industry

The U.S. is Japan's major growth market and essential to the future prosperity of a Japanese automotive industry that faces a maturing market at home. It is not that our market is growing significantly -- forecasters see an 11.5 million sales market in 1989 versus 11 million in 1985. Rather, Japan is moving to fill a major market vacuum left by American car makers. Having learned that less domestic production actually means more profit, our car makers have shed unprofitable small car lines. The U.S. move has paved the way for peaceful coexistence and profitable partnership between auto making industries. While doing so, it has played into the hands of Japanese car makers and their supplier families, long bent on controlling the equipment markets for all cars sold in America. They could achieve that feat as early as 1988.

Japan's gameplan goes beyond scoring sales growth. Rather, their objective is to wrest control of the real prize in the U.S. automotive industry, the automotive supplier industry, representing two-thirds of industry riches. Their plan now has run into the wall of U.S. industry and government resistance. U.S. industry and government now insist on fair access to Japanese OE and replacement parts markets wherever Japan builds and sells cars.

Japan for some time has been sensitive to U.S. political attention to their moves. First it learned that it could not take increasing market share with its direct imports. But, as I will show, although the spots have changed color, it is the same carnivore at work -- continuing to carry American profits and jobs back to Japan.

When Japanese imports grazed the two million sales mark in 1980, America's auto makers and government blew the whistle and imposed a so called voluntary restraint agreement (VRA) on Japanese exports. In 1981, imports were cut back sharply to 1.68 million units. With U.S. parts export sales to Japan hovering around $100 million, the American content in Japan imports was -- and still is at $200 million -- less than one percent.

Ironically, the car makers who wanted the VRA for breathing room to develop the right small car product mix, never turned the corner on making a profitable small car. All the U.S. car makers were happy to see the VRA die in 1984. This ushered in the era of captive imports, made for hire by companies in which U.S. car firms bought substantial equity holdings: GM joined to Suzuki and Isuzu; Chrysler and Mitsubishi; and Ford and Mazda. The Big Three already have moved on to South Korea, Mexico, Taiwan, Brazil and elsewhere with similar investments. By 1989, captive imports will account for more than 1 million sales by the Big Three, with cars bearing little more American content than the name itself.

Phase Two

As Detroit honed its new survival strategy, the Japanese moved to phase two of their plan -- the transplanting of Japanese vehicle assembly operations onto U.S. soil. This second wave was borne of a plan to skirt politically sticky issues such as quotas and the perennial domestic content debate. While substantial Japanese investment went into sinking the roots of these vehicle assembly plants, those roots remain shallow and have not tapped deep into U.S. supply lines.

Indeed, American firms need not travel to Japan to face rejection, for they can find it right in Japan's transplants. While we are pleased for every firm that won contracts, we would caution that little of what we define as parts is included. Many of the products are generic--such as steel, glass, carpeting, sealants--and don't buy us anything in aftermarket sales or export opportunities. Virtually every major system, from engines and transaxles to brakes and electrical, comes from Japan.

These practices run counter to commitments made in Japan's 1980 agreement to make significantly greater U.S. auto parts purchases. That agreement recognized the importance of what we call "linkage." Linkage is the relationship between OE and aftermarket manufacturing that allows a firm to produce replacement components for engines, transaxles and a host of other hard parts because the OE tooling already is in place. Denied linkage over the last seven years, U.S. firms have not achieved the significant gains in sales to the U.S. aftermarket for Japanese cars forecast by Japan in 1980. Nor have they been able to contest foreign aftermarkets for Japanese-made cars.

Despite sketchy information on transplants' local sourcing, top Japanese industry analysts peg the domestic content of parts and components used in these transplants at a scant 20-25 percent.

Japanese OEM's contend that these U.S. operations will displace imports, yet industry projections show that Japanese transplants' 1989 output will clearly supplement imports with more than one million cars. This further displaces traditional domestic production.

As with the first wave, there is a way for the Big Three to profit. The strategy is to join their partners in U.S.-based joint ventures. Projected for American suppliers is only a 20-30 percent domestic content share for the nearly 350,000 hybrids produced in 1989.

Third Wave

Even that meager share would prove much higher than American-owned firms could gain in the face of the third, and by far worst, wave: the migration of more than 300 Japanese auto parts makers to the U.S. by 1988. When they arrive, all remaining distinctions will blur, and the "domestic content" used in transplant and hybrid production will soar. And, these Japanese suppliers will compete with U.S. parts makers for the U.S. aftermarket while expanding their already extensive supply of components to the Big Three.

Finally, let me note what we term the invisible import. Hidden under the hoods of the all American car is a growing percentage of parts and components sourced by foreign owned suppliers. By 1989 these imports could rise to 20 percent or more of each domestic car, effectively making one of every five cars an invisible import.

Japanese Takeover Would Prove Disastrous

Families of Japanese auto makers, suppliers and banks long have planned to own the American automotive supplier industry, the largest in the world. Ironically, it was many American voices -- not APAA's -- who invited the Japanese -- in the hopes of easing bilateral trade frictions and reducing trade deficits. Should the last wave hit as a full frontal assult on American industry, we believe that a large part of the ownership of this bulwark of America's economy would change hands.

Would it make any difference if well respected Japanese car companies and suppliers controlled the content of the majority of cars sold in America? After all, it would trim back the vast and rapidly widening parts trade deficit, wouldn't it?

APAA believes that a Japanese takeover would prove disastrous for America's economy. It would help curb the parts trade deficit, but at the cost of further deterioration of our balance of payments account with Japan. Billions of dollars of industry profits would move to foreign hands, while American entrepreneurs and equity holders would suffer huge losses.

But the sacking of U.S. profits would not end there. Here are some examples of what lay ahead for other major American sectors: Japanese bankers will finance the new plants and Japanese construction contractors will build them; Japanese capital goods will equip them; and a good deal of the steel will be imported. Japanese investment, like trade, means keeping the money in the family.

Would there be any tradeoff in the way of more competitive car pricing? Perhaps for a season, until stronger control is achieved. Then it will be back to whatever price the market will bear. This is evidenced most clearly during the many years when the Japanese had a 25 percent currency advantage, yet never passed on any competitive price breaks. And, whatever remained of traditional American car producers would not be seen so much as competitors, but rather as customers, for Japanese car makers' supplier families. As for the aftermarket, parts prices could soar as Japanese OEM's tighten their grip over a greater number of parts available solely through their distribution networks.

If that sounds inflationary, consider the strain to be placed on scarce national resources as the Japanese superimpose a brand new supplier network on top of a viable American network. This costly waste will force the deferral of many genuine capital needs.

Employment and Security

The UAW estimates that by 1990 closed Japanese parts markets could cost 500,000 American auto making and supplier jobs.

Since the U.S. new car market is flat -- and projected to remain so throughout this decade -- each Japanese import and each car assembled here by transplanted Japanese OEM's will displace a unit of domestic OEM production. Cars now made with 90 percent plus domestic content will be displaced by transplant production that uses less than 25 percent American content. Imports with little if any U.S. made parts round out the bleak picture.

In fact, a recent UAW study shows transplanted Japanese assembly plants providing only one-fourth the job benefits that a U.S. plant gives, because the parts are made in Japan. And the same will hold true for transplanted component manufacturers who keep high value added subcomponent manufacturing in Japan. As assemblers of subcomponents, they provide only 35-40 percent of the jobs found in comparable U.S. parts manufacturing plants.

Since Japanese manufacturers' facilities often are little more than assembly plants, a critical body of U.S. engineering and technical expertise is being exported. Critics have charged that key sectors of our economy could become "screwdriver" operations with "value added" functions performed in Japan.

Having considered these threats to the nation's economy, we also must note the peril posed to national security. A weak, U.S. controlled supplier base would compromise the nation's industrial and military strength.

Urgent Need For An American Parts Policy

Our sense of urgency about the MOSS talks is warranted, for our industry clearly is in a state of wrenching transition. The record profits of the U.S. OEM's belie the fact that TWO-THIRDS of the U.S. automotive industry -- the suppliers -- have only partially recovered from the auto making depression. With U.S. car export production only a shadow of its former self and with virtually no American car exports pulling U.S. made replacement parts behind them, demand for our products is down. U.S. OEM's have stepped up their outsourcing to contain costs on their remaining production. And, anxious to shed nonprofitable small car lines, they have added to the flood of Japanese imports bearing little if any U.S. content by hiring Japanese partners to make their small car lines. Our domestic aftermarket sales erode further as Japanese made cars gain more prominence in the U.S. car population. And, Japanese auto makers manipulate markets worldwide foisting their closed dealership and supply networks on other aftermarkets.

And these riptides are trying to pull us under domestically just as the U.S. government, in a misguided and shortsighted effort to cut costs, is reducing programs and closing consulates that promote U.S. exports and provide us with the essentials for conducting business internationally.

APAA Observations On The MOSS Talks

Concerning the crucial MOSS talks, APAA offers the following observations:

1) The U.S. should press for Japanese reinstatement of the principles of a 1980 agreement to make significantly greater U.S. auto parts purchases. The problems of closed OE and replacement parts markets are just as valid today; an agenda for remedial action as timely.

The U.S. should insist on Japan's achieving our two top objectives, applicable wherever Japan builds and sells cars: (1) removal of structural impediments to OE sales, and (2) access to the global aftermarket for Japanese cars.

2) Since private, not government barriers, are at issue, U.S. sales targets and timetables are vital. The Japanese themselves in 1980 established a sound basis for measurement. They set a goal of $300 million in purchases for 1981, to be followed by significant increases thereafter. Six years later, the Japanese have barely passed the half way mark of the original target.

Since the 1981 target of $300 million in parts exports to Japan represented 16 percent of Japan's $1.8 billion in parts exports to the U.S., the same ratio could be applied to 1987 trade as a logical minimum for Japanese purchases from American owned suppliers. With Japan's 1987 parts exports to exceed $7.4 billion, it would be reasonable to expect that a minimum for Japan's 1987 purchases from American owned firms be set at $1.2 billion (16 percent of $7.4 billion), with a doubling in such purchases expected in each subsequent year until reciprocal market access is achieved.

Regardless of how we set the benchmarks, reciprocal market access must be the ultimate objective. Monitoring of Japanese purchases of our goods should continue until significant and continuous volume increases are assured.

3) Moves by transplanted OEM's to encourage relocation of their supplier families could shut the door permanently on American parts sales. They are not market opening gestures. U.S. discouragement of further investment should be the corollary to our top objective of OE market access. The migration could be averted if transplanted OEM's show good faith by turning to existing American sources. Independent studies show, and Japan's OEM's know, there are highly competitive U.S. manufacturers in every automotive product category.

Ending Government Subsidies For Foreign Firms

The U.S. market is as open as theirs is closed. The question of continued openness provides our ultimate leverage. APAA urges specific interim steps that we can take to end Japanese exploitation of that openness. None are protectionist: all would put an end to government subsidization of foreign firms.

1) A Congressional push may be needed to put the federal house in order on the Japanese supplier investment issue. Market facts should convince federal and state leaders that by encouraging new capacity to serve a flat market they are helping foreign firms displace the market share of existing firms. If the states persist, legislation should be considered to ban use of federal funds for such purposes.

2) Hold the line on new Foreign Trade (FTZ) subzone grants for auto making, until we can see whether they serve the public interest. Japanese OEM transplants now benefit the most from the program, enjoying significant tariff savings on huge shipments of Japanese parts imports. The effect is to boost the competitiveness of Japanese parts imports at the expense of American suppliers and their workers.

The method for weighing the public benefits also needs revamping, from parochial considerations of local/regional gain, to the consideration of potential consequences for the nation. The FTZ Board's guidelines for subzone applications could form the basis for public interest evaluation, and we urge their adoption as rules. We also urge Congressional consideration of legislation that: (a) sets a strict public interest standard in terms of national economic interests; and (b) subjects subzone applications to the Administrative Procedures Act, especially the public hearing requirement. These steps would build a framework for judging both prospective and existing subzones.

3) Duty-free access for OE shipments allowed under the U.S.-Canada Auto Pact has become a selling point to lure Japanese suppliers to Canada. This abuse by unintended third party beneficiaries demands our reevaluation of the Pact.

APAA has sought and gained the assurances of key negotiators that the U.S. would raise the Auto Pact and all other aspects of our automotive products trade relationship during bilateral talks. We warned that any elimination of aftermarket tariffs, without first clearing away trade distorting OE practices, would invite a duty-free blitz on our huge $100 billion aftermarket.

As longstanding opponents of U.S. domestic content legislation, we urge the elimination of Canadian domestic content and production safeguards. APAA opposes any effort to extend these trade distorting practices to all OEM's marketing cars in Canada, as has been proposed by many leaders of Canadian industry, labor and government. This move would spur foreign automotive supplier migration to Canada, where they gain duty-free access to the U.S.

APAA also objects to Canadian use of a duty remission program that grants duty relief on cars and/or parts in exchange for investment in Canadian auto making/parts making plants that export from Canada. Given duty free OE access to the U.S., the plan's net effect is to provide further rewards for foreign parts supplier investment in Canada.

Whether the U.S. and Canada move to a complete free trade agreement in all automotive products trade, or agree to modify the Auto Pact, we urge the creation of some safeguard to prevent foreign-owned suppliers from making either nation the base for a wholesale duty-free launch on the other market. One means of doing this might be to hold new to market North American firms to a scheduled phase-in, that limits the percentage of total production eligible for duty free treatment.

We have recommended actions which taken now in a nonprotectionist manner will demonstrate U.S. resolve to open markets for U.S. automotive suppliers.

Another Canadian duty remission program, now under U.S. government attack as an export subsidy, ties the value of vehicle duty remission to the value of Canadian content exported to the foreign-based auto maker, regardless of whether that content returns to Canada. Since this means that cars destined for other markets may carry Canadian content -- opening new markets to their aftermarket exports -- the program makes sense.

That is why the APAA/APEC Parts Purchase Incentive Plan was tailored after the Canadian plan. If Canada wins its fight to keep this facet of its duty remission program, we urge prompt enactment of our Plan. As the lever -- an economic incentive -- to pry open Japan's closed OEM's, we believe the Plan would create jobs, equip vehicle imports with American products and set off a chain reaction of growth in aftermarket sales.

The incentive to buy U.S. would be a dollar of credit against vehicle duty for each dollar of American product purchased by foreign based auto makers. And, best of all, it is a trade builder, not a trade blocker.

We believe that all of the actions discussed would be appropriate features for any comprehensive trade bill. We believe this is the time to craft legislation addressing auto parts trade problems. In particular, the enactment of provisions that identify barriers, set negotiating objectives, and create leverage tools, would boost industry competitiveness. It would bolster the current MOSS talks, provide for post-MOSS needs, and assist our campaigns to open other crucial markets.

Mr. Chairman, APAA believes that trade law reform should respond squarely to foreign practices that block our exports or target domination of our market. Then, Congress should push to make sure the laws are enforced. While we have worked with government to catalogue unfair trade practices of other nations and industries that block U.S. automotive product exports, we have singled out emerging auto powers such as South Korea, Taiwan, Mexico, and Brazil. Trade distortions in these nations demand action now to avoid a repeat of Japanese-style one-way trade.

The move toward trade law reform is an important part of a long awaited broad industrial policy integrating the needs of U.S. industry into that policy. In short, we need a cohesive and consistent approach to taxation, regulation, currency valuation, and deficit reduction. Getting more specific, our trade and tax experts should evaluate our competitors' tax systems and report how well the U.S. code stands up to global competition.

The ordered march to a balanced budget together with the push for sound international monetary policy, gives us hope that the currently favorable yen:dollar relationship will last.

Concerning parts trade policy, APAA believes it is time for our industry to have its own policy voice at DOC. American OEM's and parts makers have widely divergent strategies and needs. Consider how domestic auto makers' growing reliance on foreign sourced parts and entire car lines, and their other strategies discussed above, contrast starkly with American suppliers' drive to export and be integrated into the global system.

Conclusion

As Commerce Undersecretary Bruce Smart has so aptly stated, Japanese OEM's who have benefited the most from open U.S. markets also stand to lose the most, unless Congress is satisfied that parts markets are opening and there are bottom line results. Access to the huge U.S. marketplace offers the ultimate leverage.

We look forward to working with this committee to shape legislation that uses that lever to pry open other markets.

APAA is anxious to work with Congress and the Administration on our proposals and the development of other viable solutions.

Thank you for this opportunity to review the global parts trade picture with all of its challenges and opportunities. We would be happy to answer any questions you may have.

STATEMENT OF ROBERT RONZONI, PRESIDENT, RONZONI FOODS CORP., ON BEHALF OF THE NATIONAL PASTA ASSOCIATION, LONG ISLAND CITY, NY, ACCOMPANIED BY PAUL ROSENTHAL, COLLIER, SHANNON, RILL AND SCOTT, COUNSEL TO THE NATIONAL PASTA ASSOCIATION

Mr. RONZONI. My name is Robert Ronzoni. I am President of Ronzoni Foods Corporation, a wholly owned subsidiary of General Foods Corporation, headquartered in Long Island City, New York. My company is one of the largest producers of quality pasta products in the United States. I am appearing before the committee today as chairman-elect of the National Pasta Association, a nonprofit trade association representing domestic producers of pasta, and allied industries including the farm community.

I am accompanied by Paul Rosenthal, Counsel, from Collier, Shannon, Rill, and Scott. We thank you for the opportunity to appear before you this morning.

The National Pasta Association supports the provisions in S. 490 that would impose strict time limits on action by the Administration under Section 301.

The Association also supports the provisions requiring mandatory action after a GATT finding in favor of the U.S. position on a particular matter.

Although the President should retain some flexibility under Section 301, the National Pasta Association feels that S. 490 provides the President with ample flexibility. The National Pasta Association does not favor unthinking retaliation. A negotiated solution of a dispute is always preferable.

Unless our trading partners believe that U.S. threats to retaliate will be backed up by action, our negotiators will be at a disadvantage. Therefore, making retaliation mandatory in certain instances will provide useful leverage for U.S. negotiators.

The National Pasta Association's experience under Section 301 has been long and frustrating. Even after the 1983 GATT panel determination confirming the illegality of the EC subsidy, the EC refused to agree to a solution that would result in the withdrawal of the subsidy. The U.S. refused to take action with respect to the pasta case on its own merits. Retaliatory tariffs were imposed on imported pasta to pressure the EC on the citrus case. When the citrus case was settled and the tariffs withdrawn on pasta, imports of pasta increased dramatically. All that the U.S. pasta industry got from the end of the so-called "pasta wars" was an agreement to negotiate. Thus, five years after the case had begun and two and a half years after the GATT panel ruled for the U.S., the EC and the U.S. are finally negotiating.

Our view that Section 301 needs amendment is not meant as a criticism of the Administration. The Administration has worked hard to negotiate a resolution of the pasta dispute. We appreciate the Administration's efforts and recognize that the problem has been the EC's historical refusal to eliminate their subsidies. That is why the National Pasta Association strongly supports S. 543 sponsored by Senators Heinz, Roth, Spector, Reigle, D'Amato, Moynihan and Kerry. S. 543 would reimpose tariffs on imported pasta to offset the EC subsidy unless the EC agrees by July 1, 1987 to eliminate or offset its illegal subsidy. No tariffs would go into effect if the EC abides by its promise to reach a negotiated settlement by July 1.

The domestic pasta industry has waited almost six years for a resolution of its dispute. Indeed, the industry has prevailed before the highest tribunal that has considered the case. If the pasta industry cannot obtain lasting relief under Section 301 in the wake of its victory, something is wrong. The message in this unfortunate experience must not be lost on the committee. It certainly will not be lost on our trading partners who continue to violate the accepted norms of the international trading system with impunity.

We commend the committee for recognizing the need to change Section 301, so that it will be a credible tool to enforce U.S. rights in international trade.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Ronzoni, and I apologize for the mispronunciation of your name earlier.

[Mr. Ronzoni's prepared testimony follows:]

BEFORE THE COMMITTEE ON FINANCE
UNITED STATES SENATE

HEARINGS ON LEGISLATION TO IMPROVE ENFORCEMENT OF TRADE AGREEMENTS

STATEMENT OF ROBERT E. RONZONI
ON BEHALF OF THE NATIONAL PASTA ASSOCIATION
SUBMITTED TO THE COMMITTEE ON FINANCE
UNITED STATES SENATE

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March 17, 1987

My name is Robert E. Ronzoni. I am President, Ronzoni Foods Corporation, a wholly-owned subsidiary of General Foods Corporation, headquartered in Long Island City, New York. My company is one of the largest producers of quality pasta products in the United States. I am appearing before the Committee today as Chairman of the National Pasta Association, a nonprofit trade association representing all domestic producers of pasta and allied industries including the farm community.

The long and frustrating history of the domestic pasta industry with section 301 is well-known to this Committee. The industry filed a 301 petition in 1981 alleging that the EC conferred illegal subsidies on Italian pasta exports. What follows is a testimony to the inadequacy of the statute that includes:

- Failed consultations.
- A 1983 GATT Panel determination confirming the illegality of the subsidies.
- The EC's refusal to agree to a solution that would result in the withdrawal of the subsidies.
- The blocking by the EC of all efforts to secure adoption of the Panel report.
- A reluctance by the Executive Branch to use its retaliatory authority under section 301 to act unilaterally against the illegal subsidies.

Equally frustrating has been the economic impact reflected in: (1) a ten-fold increase in the level of illegally subsidized imports since 1975; and (2) record high levels in the rate of the subsidy — more than 50 percent of the value of the imported product.

President Reagan imposed duties ranging from 25 to 40 percent on imports of pasta products from the EC on November 1, 1985, but this action was taken in response to the EC's refusal to act on another GATT Panel determination on citrus. Ironically, the issue of the pasta subsidies was never raised in the public announcements surrounding the retaliation. Pasta was simply a vehicle to help resolve the citrus dispute. Nevertheless, I do not view the imposition of the tariffs as a windfall to the pasta industry. Our case deserved action on its own merits.

The tariffs on imported pasta were removed in August of 1986, as part of the U.S.-EC resolution of the citrus dispute. Not surprising, imports of pasta in the fourth quarter of 1986 exceeded any quarterly total in history.

Ironically, the newspaper accounts of the August agreement proclaimed an end to the so-called "pasta war." Unfortunately, the main casualty of the agreement was the U.S. pasta industry. All we received from the citrus agreement was an elimination of tariffs in the face of increasing EC subsidies on pasta -- and an agreement by the EC to finally negotiate in good faith on the pasta issue. Thus, five years after the case had begun and 2-1/2 years after a GATT panel ruled for the U.S., the EC finally agreed to negotiate. Is is any wonder that the National Pasta Association believes that section 301 needs amendment?

The domestic pasta industry was one of the first to avail itself of section 301. Yet, its GATT Panel victory has been overlooked and submerged in a morass of procedural maneuverings. If section 301 is to be the vehicle for seeking enforcement of rights under trade agreements, it must provide our negotiators with the leverage to resolve disputes arising under those agreements. That leverage can best be provided by a requirement that retaliation be mandated in the event of an affirmative GATT panel determination concerning the illegality of a foreign practice, and a failure on the part of the U.S. and the offending country to reach a favorable solution shortly thereafter. Without that leverage, section 301 and the entire dispute settlement process will be ineffective, and the agreements themselves unenforceable.

It is for these reasons that the National Pasta Association supports the approach of S.490. We recognize that the President must have some discretion in administering this important statutory provision. S. 490 quite appropriately limits -- but does not eliminate -- that discretion. S. 490 provides more than ample flexibility for the Administration.

Our view that seciton 301 needs amendment is not meant as a criticism of the Administration. The Administration has worked hard to negotiate a resolution of the pasta dispute. We appreciate the Administration's efforts and recognize that the problem has been the EC's historic refusal to eliminate their subsidies. That is why the National Pasta Association strongly supports S. 543, sponsored by Senators Heinz, Roth, Spector, Reigle, D'Amato, Moynihan and Kerr. S. 543 would reimpose tariffs on imported pasta to offset the EC subsidy unless the EC agrees by July 1, 1981 to eliminate or offset its illegal subsidy. No tariffs would go into effect if the EC abides by its promise to reach a negotiated settlement by July 1.

The domestic pasta industry has waited almost six years for a resolution of its dispute. Indeed, the industry has prevailed before the highest tribunal that has considered the case. If the pasta industry cannot obtain lasting relief under section 301 in the wake of its victory, something is wrong. The message in this unfortunate experience must not be lost on this Committee. It certainly will not be lost on our trading partners, who continue to violate the accepted norms of the international trading system with impunity. We commend the Committee for reconignizing the need to change section 301 so that it will be a credible tool to enforce U.S. rights in international trade.

The CHAIRMAN. Because of the limitations of time, I want to add to the panel Mr. Clyde Prestowitz, who is the former Counselor to the Secretary of Commerce and a Fellow at the Woodrow Wilson Center of the Smithsonian Institution in Washington.

Mr. Prestowitz, if you would, proceed with your testimony.

CLYDE PRESTOWITZ, FELLOW, WOODROW WILSON CENTER, SMITHSONIAN INSTITUTION, WASHINGTON, DC

Mr. PRESTOWITZ. Thank you, Mr. Chairman.

Mr. Chairman, I would like to refer to two experiences that I had in my years as a trade negotiator in the Administration—one of them is the Hudai Case which Phil O'Reilly has mentioned before. I won't go through the history of that, but the conclusion of that case I think is important as it bears on the subject you are considering.

The case took about 13 months to resolve. It was the subject of bitter debate within the Administration. Ultimately a team of eight people were appointed to write a recommendation paper, a decision memo to the President. I was one of those eight people.

The team of eight was split. The Commerce Department, the Labor Department, and USTR favored taking some action; the other departments of the government were against it, for reasons both of economics and politics.

In any case, ultimately we settled on the following procedure. There were great disagreements amongst us as to exactly what the Japanese were doing, so we made a list of the things that we all agreed the Japanese were doing. Anything that was not unanimously agreed, we threw out. We then compared that list of subsidizations and cartel operations that we all agreed the Japanese were doing to U.S. law and international trade law, and we posed the question: How many of these things on our list are in violation of U.S. law or international trade law? If we were lawyers for the prosecution, would we think we had a case?

Out of the eight items on our list, we said that six of them were substantially in violation and that we as lawyers thought we would have a case. The obvious question then was, okay, if we agree on these facts, we agree they are in violation of the law, then we ought to enforce the law and write a recommendation to the President to take action under Section 301. We could not get such a recommendation written. The State Department did not want to take any strong action against Japan because it never wants to upset our relationship with Japan. The National Security Council was concerned about Japan endorsing SDI and about Japan's support in the UN, and they opposed it. Other agencies had other reasons for opposing it.

The upshot was that the paper was sent to the President without a recommendation. At the last minute, the Prime Minister of Japan sent a personal message to the President asking him to lay off, and the decision was made to take no action.

Now, I was engaged in another negotiation on whaling. As you know, the Packwood/Magnudsen Act stipulates that any country which whales in violation of the recommendations of the International Whaling Commission automatically loses 50 percent of its fishing allocation in U.S. waters. The Secretary of Commerce is charged with the administration of the Packwood/Magnudsen Act. He has no discretion. He must automatically reduce fishing allocation by 50 percent for any country whaling in violation.

In 1984, the Japanese whaling fleet put to sea. They sent a delegation to see the Secretary of Commerce, and effectively they said to him, "We know you have this Packwood/Magnudsen Act, sir, but you are really not serious about that, are you? You are not going to enforce that." And the secretary said, well, yes, he was. The delegation then visited the State Department and the National Security Council and the White House, and a number of other bodies, and pleaded their cause.

Now, Mr. Chairman, the Secretary of State very rarely visits the Commerce Department, but on this occasion the Secretary of State visited the Commerce Department and asked the Secretary of Commerce if he had any wiggle room. And other members of the government called the Secretary and asked him if he had any wiggle room. The Secretary of Commerce was in a beautiful position; he said, "You know, I really feel sorry for those fishermen on those whalers, and I understand the problem. I am sympathetic. I know that eating whale meat has been a part of the Japanese culture for a thousand years, but I don't have any discretion; I have to enforce the law."

Mr. Chairman, Japanese no longer "whale," they "fish."

Thank you, sir.

[Mr. Prestowitz's prepared testimony follows:]

Testimony of
Clyde V. Prestowitz
before the
Senate Finance Committee
March 17, 1987

I would like to make three major points. The first has to do with the question of open markets and market opening exercises. We in the United States think of "open" as being the proper, desirable, and natural state of markets. We never stop to consider what we mean by "open." We tend to assume that "open" means open. But in fact our use of the term "open" is derived from the kind of society we are and from our historical development. Implicit in the word "open" are a lot of things that we never even bother to articulate.

For example, when we say "open" in terms of an open market, we include in that the assumption that a buyer is prepared to change suppliers if a new supplier offers the same goods at a better price or better goods at the same price or in some other way offers a better deal. Implicit in the use of the term"open" are the assumptions that there will be a functioning judicial system that will deliver justice more or less fairly and rapidly; that there is due process; that a single American citizen can get an injunction against his own government and stop that government cold in its tracks if need be; that the lawmaking procedures are open; that constituents can observe the laws being debated; that they can lobby their representatives; that they can attend hearings and that nothing will be done in secret or behind closed doors. In other words, our use of the term "open" derives from our rights as individual Americans in a society dedicated to freedom of the individual.

Now the fact is that most societies in the world do not have that kind of openness, and it's natural that they should not. We, after all, are an immigrant society. Immigrant societies tend to devise methods of absorbing and welcoming outsiders; more traditional societies do not. In Japan, for example, we have the world's most homogeneous society. The Prime Minister of Japan lauds the homogeneity and sees it as a major factor in Japan's success. It is a society which for most of its history has attempted to wall itself off from outsiders. In Japan due process is not the same as in the United States. Laws and rules are written in secrecy in ministries. One cannot attend the mark-ups or attend the hearings as an outsider. The judicial system essentially doesn't work. A single citizen cannot stop the government in its tracks. Relationships between buyers and suppliers tend to be on the basis of personal ties. A buyer will not change suppliers because someone new offers him a better deal. He may go back to his original supplier and renegotiate the terms, but he will not abandon the original supplier.

So all this means that the Japanese and other countries do not have the same understanding of the term that we have. In fact they can't open even if they so desire. I have seen

Japanese sincerely attempting to respond to American demands to open the market, but since they didn't know what open was, their response was inadequate. It was in terms of the Japanese understanding of "open," which is very different from ours. But when the Japanese or others respond in what we perceive as an insufficient way, we Americans tend to think they are cheating and we accuse them of being unfair. They respond by saying, "No, we're not being unfair. It's just that Americans don't work hard enough, don't try hard enough. Their products are sloppy and their service is lousy." The debate then goes into a downward spiral and becomes more corrosivce as time goes by and trade frictions, which everyone tries to avoid, become a major negative factor in relationships which are otherwise pretty good.

The whole fault lies with the assumption by Americans that they can get open markets if they just somehow explain themselves long enough and loud enough. The fact is societies like Japan or even France or Korea are closed societies. It's very difficult to enter those societies. It's very difficult for Japanese. Even Japanese who have been living abroad for some time have difficulty re-integrating their children into schools and into Japanese society. If it's difficult for Japanese to integrate into their own society, clearly it must be difficult for foreigners. And if it's difficult for foreigners to integrate into the society, then obviously it has to be difficult to sell and to market and to enter the market. And in fact that is the experience.

Now the second point has to do with the nature of different industries. Again, we tend in our trade relationships to demand that our trading partners open particular markets such as, for example, supercomputers in Japan or informatics in Brazil or aircraft in Europe. Our demand for these openings is again based on our view or assumption that these markets are just like any other markets and that the best mode of operation of markets is to be open on an international basis. But the fact is that some of these markets have unusual characteristics. Think for a moment about one area of the economy that we all use to a great extent which works pretty well, is fully international, and in which we do not demand free trade. This is the airline business. Every country has an airline, some have several. We all use them, we all manage to travel internationally without too much trouble, the prices are reasonable, and yet we do not insist on free trade. Why is that?

We don't do that because everybody knows that to be a real country, you have to have an airline. Having an airline is part of being a sovereign nation, and we would not demand that another country stop its airline service because to do so would be to impinge upon its sovereignty. Now the American airlines are the low cost carriers. If there were free trade in airlines, the American carriers would carry all the world's passengers. But there is no such trade, and we don't insist on it because we recognize this is an area of the economy which is run not so much for economic reasons as for other psychological and political reasons.

However, airlines are not the only kind of industry that have this characteristic. Some countries like Brazil have decided that they have to have an informatics industry to be a real country. The French and the Europeans have decided that they have to build airbuses to be real Europeans. The Japanese decided they had to make semiconductors to be real Japanese.

When we face industries like that with a motivation behind the development of the industry that is not economic or is only secondarily economic, it's clear that they really are non-negotiable. We cannot persuade them to open these markets because to do so would be to destroy the very reason for their existence. In fact, the more we insist on negotiation, the less chance there is of opening them because our insistence is a challenge to the sovereignty of the nation involved, and they become more stubborn. Or if by dint of overwhelming power we are able to force them to make some change, they resent it and resentment and irritation fester and grow and tend to harm other parts of the relationship. So again, it really is foolish and counterproductive to insist on openings of these kinds of markets. Much better, really, to recognize the nature of the societies we are dealing with, to recognize that certain kinds of industries are supported by interests that are broader than economic interests and to negotiate accordingly. It doesn't mean that we can't trade. It doesn't mean that we have to wall our markets entirely off. But it means that we negotiate as we do over airlines, on a reciprocal balance of business, results-oriented basis, rather than on a procedural basis which is doomed to failure because the motivation supporting the industry has nothing to do with procedures.

The third point is that the organizations governing international trade, namely the GATT and OECD, having been built as they were in the post-war period and largely under American tutelage, are based on the same assumptions and are therefore seriously flawed with respect to adequately governing world trade on a fair basis today.

The two key flaws are national treatment and most-favored nation treatment. These are the two pillars of the GATT and superficially they sound quite reasonable. It seems fair that if I treat your companies the way I treat my companies, you do the same, then everything is fair and square. But consider a foreign company that incorporates a subsidiary in the United States. That subsidiary is legally an American citizen. It has the right to defend itself using U.S. laws. It can lobby the Congress. It can participate in industry associations. It can participate in hearings. It has all the rights and privileges of an

American citizen. Conversely, an American company in Korea or in Japan may be treated as a Korean or a Japanese company. In those countries, companies are subject to administrative guidance. Only with difficulty do they have recourse to the legal system. Companies are discriminated against within the country. The government favors some companies over others. There are clear and explicit guidelines which effectively discriminate against foreign companies. The difficulty is that if one country treats its citizens poorly, and another country treats its citizens well, national treatment will wind up disadvantaging the citizens of the more liberal country in any international undertaking. And that, in fact, is what national treatment does to the United States under the GATT.

Most-favored nation is similar. If we give a concession to Canada, for example, we automatically have to give it to Korea, and yet we get nothing in return. So one of the things I suggest you consider is the administration's desire to have a grant of negotiating authority. No authority should be granted unless there is a commitment to negotiating an agenda which includes the issues of national treatment and most-favored nation. If that kind of basic, fundamental agenda which aims at righting the basic problems in international trade cannot be pursued, there really is no sense in pursuing a peripheral agenda which talks about in one form or another the same problems we're talked about for years, because it will have the same result -- that is to say, no result. In fact, it would be counterproductive, because while we're negotiating, we will use that as an excuse not to take other actions, telling ourselves that we have to wait to see whether the negotiations pan out or not. So in that sense, better no negotiations than flawed negotiations.

Finally, the organization of the U.S. government to deal with trade problems leaves a great deal to be desired. Consider for a moment that the Commerce Department is responsible for administration of trade policy and it also has the analytical arm used for doing industry analysis and economic analysis on which the development of trade policy is based. But the USTR has responsibility for the development of trade policy. At the same time, the ExIm Bank is off by itself and is responsible for the promotion of trade. The Commerce Department has some trade promotion responsibility. OPIC, the international insuring agency, is off by itself as an independent agency. The national laboratories which have a potentially enormous contribution to make to America's international competitiveness are under the Energy Department. NASA, which also has an enormous potential contribution to make to American industry, is in an independent posture, not really knowing what it is supposed to do. The State Department, the National Security Council, the Treasury Department, the Agriculture Department, all are participating in the development and execution of trade policy. It's an extremely unwieldy, disorganized kind of mechanism, and the result is that there aren't many results because it's extremely difficult to get a consensus to bring to bear all of the factors that need to be brought to bear.

Moreover, one of the biggest impacts on our trade position is in the area of technology transfer. It's ironic that Richard Perle at the Defense Department is adamant about holding up licenses or exports of products that have obsolete technology while at the same time Defense is the biggest donater of technology to our competitors. At the moment, for example, we're putting the Koreans into the aircraft manufacturing business. Our co-production arrangements with the Japanese and others have resulted in transfer at minimal cost of priceless technology which has come back to haunt us in the form of products competitive with our own. And yet, mind you, when those co-production decisions are made, they're made by the Secretary of Defense and the Secretary of State. The Secretary of Commerce, the Secretary of the Treasury, and the USTR are not even at the table when those decisions are made.

So I would like to suggest a reorganization of the government to deal with trade and competitiveness which would take the national laboratories, NASA, the ExIm Bank, the USTR, the Commerce Department, OPIC, the airline negotiating authority of the Department of Transportation, and combine them all into one major department which would have a big budget, which would have clout within the adminstration within Washington. The head of that department should be on the National Security Council and any decision memo going to the President should have a competitiveness impact statement so that trade and competitiveness are always at the same level of consideration as geo-politics or political situations.

In dealing with trade we really need in some ways to give the President less discretion. For example, the most successful negotiation in which I participated was over whaling. The International Whaling Commission two or three years ago passed a resolution banning most commercial whaling. In the United States we passed the Packwood-Magnuson Act which stipulates that any country which is whaling in violation of IWC recommendations will automatically lose 50% of its fishing allocation in American waters and, at the discretion of the Secretary of Commerce, may lose up to 100%.

In the fall of 1985 the Japanese whaling fleet put to sea and a delegation of Japanese came to Washington to visit the Secretary of Commerce and to confirm that he would not execute the Packwood-Magnuson Act against them. They argued that they were only engaged in coastal whaling and that whaling and the eating of whale meat has been part of Japanese culture for thousands of years. The Secretary was in a beautiful position. He could say to them he was certainly sympathetic. He understood the problem but his hands were tied. He had no discretion. Now the Secretary of State rarely darkens the door or halls of the Commerce Department, but on this occasion the Secretary of State called on the Secretary of Commerce to ask him to look for some wiggle room in the application of the Packwood-Magnuson Act. The National Security Council did the same. Had the Secretary had any discretion, the pressure on him to refrain from acting would have been overwhelming. But he was in the lovely position of being able to say that while he sympathized, he had no discretion. In the end, the Japanese agreed to stop whaling.

Almost inevitably, any economic issue that comes to the President will come to him in the context of a lot of other things. It will always be the case that the Secretary of State or the Secretary of Defense will say to the President, well, we really shouldn't retaliate with Korea, Japan, or Brazil today because they voted with use in the U.N. yesterday, they're going to give money to Corrie Aquino. For one reason or another, there is always a good reason for the President not to act to protect American economic interests. The only way to really get around that is to elevate America's economic interests to the same status that we give its political and military interests. And there are many instances in which we would not give the President discretion over certain military and political decisions and so in the trade area the President would actually be stronger without discretion than he is with discretion.

So far as fast-track authority is concerned, that's a great mistake. We would not give fast-track to a missile negotiation or a negotiation on SDI. If trade is an important as those, as I believe it is, then we should not give fast-track to that either.

I'm often asked whether the issue of barriers in Japan is a peripheral issue. In other words, economists often say the problem is the exchange rate and if all the unfair trade practices were stopped, it would only make a $10 or $12 billion difference in the trade figures with Japan. That really depends on what you define as a barrier.

If you're talking in terms of classic quotas, tariff kinds of barriers -- then, yes, the figure is probably $10 or $12 billion. But there are other more subtle forms of barriers. For example, American soda ash was competitive when the dollar was at 270 yen. Now with the dollar at 150 yen, it sells for about a $100 a ton less than Japanese ash. There's no tariff, there's no quota, and yet sales have not gone up. Why is that? It's because the Japanese trading companies who control the unloading facilities, the depots, the distribution, and who are in the same keiretsu groups as the ash manufacturers in Japan, simply have refrained from importing ash or allowing it into the distribution system. If you look for a list of trade barriers, that won't be on a list, but it is a real barrier.

The same situation exists in fertilizer, pulp, and paper. In the area of petrochemicals, the Japanese have organized what they call a number of rationalization cartels to reduce capacity in the industry. Now, when a government organizes a cartel to raise prices, it cannot in logic welcome an influx of cheaper foreign goods and so it finds ways to keep them out. In Japan, given the influence the government has over industry, given the subtle pressures that can be brought to bear by interrelated banks and industry groups, it's very easy to cause a reduction or a hold on the level of imports without resort to a more overt means that would be required in a more open society like the United States. But if we define barriers in a broad sense, then the barriers in Japan probably cost us in the area of $50 or $60 billion a year. Japan has the lowest rate of imports of manufactured goods. It takes only 8% of the manufactured goods exports of the non-oil LDCs. The United States takes 50%, the Europeans 38%. It does not carry its share of the weight and that has to do with a lot of hidden, but very real, barriers.

The CHAIRMAN. We will limit the questions of each of the Senators to five minutes.

What you are saying, in effect, is that it is a benefit in many instances to have less discretion for the President.

Mr. PRESTOWITZ. Absolutely.

The CHAIRMAN. That, in effect, time and time again trade has been used as the handmaiden to achieve other objectives for the country. And when you look at the pecking order, that the State Department and the Defense Department and the Treasury all have higher turf, they sit above the salt, and they have the muscle to see that you stymie any kind of action taken here in many instances.

Mr. PRESTOWITZ. Yes, sir. I believe, sir, that the argument that by taking the President's discretion away from him you eliminate his flexibility, and that you may thereby engender retaliation or trade wars, is 180 degrees wrong.

At the moment our negotiators—and I know this from bitter experience—go into every negotiation with a handshake and a smile. Our negotiating partners know that they do not have to make concessions to us. They know, first of all, that we put a high priority on having bases or on inducing them to contribute aid to underdeveloped countries, or whatever it is; but they know that we put a higher priority on other issues than we do on trade. They also know they have access to the White House. As you so very well know, Japan and other countries employ a large number of former high-ranking officials here in Washington. Those officials have better access in many cases to the White House than our own Administration members have.

So, they know when they negotiate with us that we have higher priorities, they know that they can get their issues to the White House, and they know that once it is in the White House, inevitably—inevitably, it is just the nature of the beast—inevitably the President must consider a trade issue in the context of the other aspects of the relationship that we have with that particular country. And inevitably, then, the trade issue gets watered down.

Now, if our trading partners knew ahead of time—as they did in the case of whales—if they knew ahead of time that it was not going to be possible to play this insiders' political game in Washington, if they knew that they would have to negotiate with us, they would negotiate with us. And in my view, we would take a lot of the poison out of the relationship rather than creating it, because at the moment what happens is that we, not having any real power, we do the opposite of what Teddy Roosevelt suggested, we talk loudly and carry a small stick. We threaten the Congress. We tell the Japanese, "Boy, if you don't shape up, the Congress is going to clobber you." And we threaten 301. We tell them, "Boy, you know, if you don't straighten out your act on semiconductors, we are going to make a flank"—but we never do it. And the result is a very long, drawn-out, corrosive process of mutual finger pointing and mutual recrimination, in which we accuse them of cheating and they say, no, they are not, and ultimately it poisons the relationship without getting any very significant concessions for us.

If they knew ahead of time that there was a sanction certain, we wouldn't have the long drawn-out process, we wouldn't have the recriminations, and I believe we would have results.

The **Chairman**. But you know, the way this bill is drafted, the discretion of the President only becomes a mandatory situation if we are talking about a violation of a trade agreement, and that, in substance, it has to be a substantial amount before it goes into effect; otherwise, the President does have discretion.

Mr. **Prestowitz**. Yes, I understand that, sir. My position is that I think the way the bill is drafted, frankly, for my taste, is not strong enough. But I feel that any move in the direction of mandatory response is a positive move.

The weakness that I see in the bill as it is drafted is that there are so many, many areas of the international trade scene in which it really is virtually impossible for us to attain market opening in other countries, and yet they are not necessarily the subject of international trade agreements. So I am concerned that if you limit it to only international trade agreements, you really cover only a very small part of the problem.

The **Chairman**. Thank you.

Senator Packwood.

Senator **Packwood**. Mr. Prestowitz, in the summary of your statement is the following statement, "Just so some countries think they have to make semiconductors and others think they have to build airplanes to be real countries, these are non-negotiable." In your fuller statement you say, "In some areas, some countries have industries because they think they have to have them, and they are not going to negotiate them away, they are not going to open up." In that case, if we have a mandatory 301 retaliation, and they are not going to open up, what will happen when we exercise the mandatory retaliation?

Mr. **Prestowitz**. Well, let me say that my preferred approach to this whole problem is not to talk about it in terms of retaliation. But unfortunately, that is the way our law is written, so that is what we do.

My feeling is this: In the case of—let's take something like Airbus. The French and the Europeans are not going to stop building Airbuses. They are not going to stop subsidizing Airbuses, and they are not going to stop compelling their airlines to buy Airbuses. That means our industry is not going to get a fair shake in the European markets, or even competition with the Airbus, just because we send a couple of negotiators out and ask the Europeans to please be good boys.

Senator **Packwood**. Or even if we threaten retaliation, apparently.

Mr. **Prestowitz**. Well, but threatening retaliation will not make them shape up. But at least what we can do, if we know they are not going to back off, we can then stop them from savaging our own industry. We can at least make sure that our own industry is not the victim of this kind of government subsidization.

Senator **Packwood**. How? If they go to MacDonnell Douglas and say, "We want to sell mid-range aircraft in Europe. We can't get in; we are having trouble with Airbus, and they are protected." And we say, "By golly, if you won't remove the protection we are going to retaliate." And they say, "Fine, go ahead." And we retaliate in some other fashion. We still haven't gotten Boeing and MacDonnell Douglas into their markets.

Mr. PRESTOWITZ. No, but you can prevent Airbus from selling airplanes to American Airlines or Eastern or Pan American.

Senator PACKWOOD. Okay. I just wanted to see what you were talking about. You are saying we will just close them out of our domestic market.

Mr. PRESTOWITZ. Well, I think what you would get is this, speaking of airlines: There is one part of the international economy that is not at all free trade, and we don't insist on it, and that is airline services. If we insisted on free trade in the airline services, the American Airlines would carry all of the world's passengers; they are the low-cost carriers. But we don't insist on that because we know "to be a real country, you have to have an airline."

Senator PACKWOOD. You have made the point, and I think you have answered my question. There are some areas where retaliation—mandatory retaliation—is not going to get the country to give up the practice we are trying to stop. They just aren't going to do it.

Mr. PRESTOWITZ. It will not, no.

Senator PACKWOOD. Let me ask Ms. Haggart a question.

You said, and I think I am quoting reasonably accurately, "Allocation of trade priorities are often subordinated to nontrade priorities." Is that roughly what you said?

Ms. HAGGART. Yes, Senator.

Senator PACKWOOD. Is that always wrong?

Ms. HAGGART. Senator, clearly there are many factors that must be considered in these cases. What is missing in the case of trade, in my own view, is the accountability in one individual that we have in other aspects of our policymaking process.

Senator PACKWOOD. But you have that in the President now, the accountability.

Ms. HAGGART. That is true, which raises the visability to a highly politically-charged level, as compared with certain aspects of economic policy, for example, that the Secretary of the Treasury can carry out. Certainly, he seeks advice from other fellow Cabinet officers, but he ultimately is accountable. Similarly, for labor problems, the Secretary of Labor is accountable. It seems to me there is an exception in the trade area, where no Cabinet official is accountable for trade policy.

Senator PACKWOOD. Well, let us assume that you shift this over to the Special Trade Representative. Should the Special Trade Representative be allowed to take into account nontrade factors and on occasion give them priority over trade?

Ms. HAGGART. It seems to me, Senator, that what industries such as mine and others represented here today are facing is a long history in this country where trade has not been a high enough priority in the national agenda. That is not the case for many of our trading partners—chief, among them, Japan—and this is what has led to the current focus of debate in this committee and elsewhere on the competitiveness of U.S. industry.

Senator **Packwood**. Should we make tit-for-tat trade retaliation mandatory and therefore exclude the consideration of other priorties?

Ms. **Haggart**. From the standpoint of the semiconductor industry, I think what the Administration does within a very short time period in terms of enforcement and implementation of our negotiated agreement will be instructive.

Senator **Packwood**. Let me get you to answer the question philosophically. Should the U.S. Trade Representative or the President take into account factors other than trade and on occasion give them priority over trade?

Ms. **Haggart**. Senator, I am not sure that there is one answer that applies across the board; I think there are case-by-case considerations that probably need to be made, although I would reiterate what Mr. Prestowitz just enunciated, and that is that many of these trade issues would be resolved much more simply and expeditiously if all parties involved—our trading partners, the U.S. industries that could be affected, as well as our government negotiators—knew that there was an action-forcing event, namely, a requirement to take action, coming down the road.

Senator **Packwood**. Thank you.

Mr. **O'Reilly**. May I just make a comment, Senator? It is in response to your question.

Senator **Packwood**. Excuse me. I didn't hear the start of what you said.

Mr. **O'Reilly**. May I comment in response to your question about are there instances where the Trade Representative ought to take into consideration issues other than trade?

I think, very obviously, there are, But they ought to be the exception. The problem we have today is that every issue goes before every agency, and they get involved in issues where they really should not be involved.

Thank you.

The **Chairman**. Senator Matsunaga?

Senator **Matsunaga**. Thank you, Mr. Chairman.

Ms. Haggart, the Section 301 case on semiconductors, in which Japan has probably been the most complex and ambitious under Section 301—based on your experience, how do you assess the functioning of Section 301, the process, and do you think the results which you anticipate could come about under the law as it is today?

Ms. **Haggart**. Senator, as I indicated, the outcome of the negotiated settlement of our case is one that did address the comprehensive and complex problems that the industry faced. However, that was seven months ago. It was a long and arduous process; it was an expensive one for the industry; it did involve dealing many nontrade considerations that were raised in the interagency process that now governs these cases; and I am not sure in the final analysis how productive that was.

The key from our industry's perspective, as I am sure you well know, is what happens now. We are over seven months past the signing of the agreement, and we still have no effective implementation of the agreement by the Japanese. We feel that enforcement is key and we must have action immediately to enforce the agreement, or this once hailed agreement will go down as one that was not effective.

Mr. **Prestowitz**. Senator, could I add something to that?

Senator **Matsunaga**. Certainly.

Mr. **Prestowitz**. I think something that is being missed here is that the 301 case in semiconductors was filed in June or July of 1984—1985, I guess it was. That case dragged on for about six months. The action-stimulating event was not the 301 case; the action-stimulating event was the self-initiation of a dumping case by the U.S. Government against the Japanese industry.

Now, that self-initiation had never been done before in the history of the U.S. Government. It came about through a fluke. In September the President made a speech in response to a lot of the argument that was being made here on The Hill. The President made a speech, and in the speech he said he had created a strike force that was going to search out and smite down unfair trade activity wherever it might be found. Well, the fact is, when he made the speech there was no strike force; but, two or three days later Secretary Baldrige was called from the White House and he said, "Matt, we need a strike force." So he was put in charge of a Cabinet-level strike force that was supposed to find unfair trade activity and smite it down. And the first thing he found was dumping of semiconductors, and he initiated—as the Secretary has the authority to do under the dumping law—he initiated a dumping case.

That dumping case would have cost the Japanese industry approximately $3 billion, and that had a date-certain on it. Once that case was initiated, there was a process that was going to come. The Japanese knew they were dumping, they knew there was an end of the line. And it was that which stimulated the negotiation, not the Section 301 case.

Senator **Matsunaga**. Are you saying that the compulsory retaliation provisions of S. 490 would assist in this regard?

Mr. **Prestowitz**. Well, sir, I think, as I said earlier, that any step in the direction of creating some certain sanction at the end of the process is a step in the right direction.

Senator **Matsunaga**. Ms. Haggart, if the export targeting provisions proposed in S. 490 had been enacted into law a few years ago, do you think it would have made any difference in the semiconductor industry's ability to challenge objectionable practices in Japan, or is the existing law already sufficient to address the industry's problem with market access? I am not talking about the dumping aspects now.

Ms. **Haggart**. Senator Matsunaga, as I indicated, ultimately the Administration found the case actionable under existing law, but there were many questions raised along the way as to whether targeting practices would in fact be covered by section 301. And in the interagency process, many individuals raised this issue.

I would also add that it is perhaps possible that the industry would have considered bringing the case earlier than it did, several years ago, before we faced the current very difficult situation we face today, had we been more certain that the actions complained of would be covered by our existing laws. And in the future, for high tech industries, it is very important for those of us faced by targeting practices of foreign governments that we have some assurance that our government will step in when these practices qive our foreign competitors an unfair disadvantage.

Senator **Matsunaga**. Thank you. I see my time has expired.

The **Chairman**. Senator Baucus.

Senator **Baucus**. Thank you, Mr. Chairman.

Mr. Prestowitz, if there is mandatory retaliation in response to unjustifiable breaches of our international trade laws, are you concerned that perhaps a reluctant Administration may not even bring those 301's in the first place?

Mr. **Prestowitz**. That is a risk. However, as you know, the 301 is triggered by a petition from private industry. Now, one of the games that is played here, of course, is whether the Administration accepts the petition or not. And I think that if there is a mandatory clause, it is possible that an Administration would be less anxious to accept a petition; but I am not sure that that is dispositive, because what I have seen in my own experience is that they are reluctant to accept petitions, anyhow, and once they have the petition they are reluctant to act on it.

You could remedy the situation by including in a law the requirement that if petitions meet certain criteria, they have to be accepted.

Senator **Baucus**. What do you think about, say, extra-economic or noneconomic forms of retaliation? One of the problems obviously, when we think a country is unfair and we retaliate, often retaliation hurts some segment of the American economy—the American consumers or some other segment of the economy. Have you given much thought to other forms of retaliation, other forms of pressure that we might exert on a country that violates a trading agreement, where Section 301 is used?

Mr. **Prestowitz**. I have thought about it, and I think this goes back to Senator Packwood's question as well. I really don't like to talk about this in terms of retaliation.

Senator **Baucus**. Don't use "retaliation." What other clubs do we have?

Mr. **Prestowitz**. Well, I really think the question is this: I don't think that a country like Japan can open its market, because it doesn't know what "open" means. I am not being facetious. The Japanese do not have our tradition of an immigrant society or due process, or open rulemaking procedures. They don't really understand the term "open" as we do. And when we ask them to "open their markets," we are asking them to do the impossible. In other cases, in strategic industries, we are asking countries to abandon industries that they have taken on for political and emotional reasons, and they are not going to do that.

I think really what we ought to do is to consider what it is that we want. We have been asking the Japanese to open their markets for semiconductors. Well, the real question is not whether or not the Japanese are going to open their market for semiconductors—they are not—the question is, do we want a semiconductor industry in this country? And if we want one, then what do we have to do to do it?

It may be that to have a semiconductor industry here we need to make some deal with the Japanese that in one way or another restricts their sales in the U.S. market, or that trades sales in their market for sales in our market. There are lots of possible outcomes. But I think the real issue is not what do we do to the Japanese, the real issue is what do we do for ourselves.

Senator **Baucus**. The Japanese are the biggest offender; aren't we going to do something to the Japanese?

Mr. **Prestowitz**. Well, as I said, it may be that if you decide that their market can't be opened and that the effect of their market not being open is that you are going to lose your industry, then you may decide that you don't want that effect. So then, you take whatever steps are necessary to avoid that effect. Those steps could include a negotiated deal as we do in airlines; they could include some limitation on trade but encouragement of investment; there are lots of alternatives—it is not all black and white.

Senator **Baucus**. But I am going to ask you to think big now, and think of some noneconomic pressure points.

Mr. **Prestowitz**. The obvious one is military, and clearly in our relations with a number of countries it would help if they spent more on their defense and we had to spend less on them. That is certainly an area that can be explored.

The **Chairman**. Senator Rockefeller.

Senator **Rockefeller**. I will be brief, Mr. Chairman.

Mr. O'Reilly, Mr. Prestowitz is such a professional on this subject that I am afraid that all of you are being ignored. So, Senator Daschle and I don't want to ignore you, Mr. O'Reilly—plus there is the fact that you do business, or used to, in West Virginia.

Senator Daschle would like you to submit for the record a sharing of your experience in obtaining information for your petition, if you would do that—not now, but for the record, afterwards.

Mr. **O'Reilly**. I would be happy to do that, Senator.

[The information follows:]

Response to Question from Senator Rockefeller

In our pursuit of evidence and documentation of the practices of the Japanese government in establishing, nurturing and protecting a cartel in the machine tool industry, my company spent in excess of $1,500,000. Our attorneys were Mr. Richard Copaken, Covington & Burling, Washington, D.C. and Mr. J. Nagashima, Nagashima & Ohno, Tokyo, Japan. In the course of our investigation, my associates at Houdaille and I made over six trips to Japan, and Mr. Copaken made over twelve trips.

In depth interviews were held with numerous officials in the Ministry of International Trade and Industry, Ministry of Finance, Ministry of Foreign Affairs, Japanese Fair Trade Commission, Japanese Export Trading Organization, The Bicycle Rehabilitation Association, Nippon Telegraph and Telephone, The Japan Railway, Japan Airlines, and many others. We were able to accumulate over 2,000 pages of documentation to support our allegations. All of the pertinent evidence was submitted to the U.S.T.R. either formally or informally -- much of it in the original Japanese language and with the translation.

There were both advocates and opponents in the President's cabinet -- but in the end -- four pages of "agreed upon facts" were submitted to the President, together with an opinion that the evidence would support whatever action the President wished to take. This statement of facts substantiated the evidence accumulated by Houdaille during OUR investigation.

Intervention at the highest level of the Japanese government directly to the President induced him to turn down the petition. Many years of effort and $1,500,000 of Houdaille funds went for naught, and Houdaille liquidated or sold four of its machine tool companies and no longer provides the livelihoods for 2,200 employees.

Senator **Rockefeller**. Ms. Haggart, let me say something—and I am not asking you to respond to this; it is not related to SIA or to 301's but to your company. Your Chairman, Bob Galvin, was here not long ago.

The decision that the Japanese Government made with respect to cellular telephones, giving Motorola an absolutely minute—even after severe pressure—portion of the market, the Japanese then keeping 75 to 90 percent of the market, in perpetuity, is not only totally unacceptable in and of itself in that Motorola's cellular product is superb, but it is also part of the frustration that we feel here in dealing with this question of 301's and trade policy as a whole.

The Administration acquiesced to that small section of the market which was granted you, and nothing was said. I don't ask for your comment on that, but I want to make that point.

Mr. Prestowitz, we seem to be hung up over 301 retaliation. "If we retaliate, does the world collapse around us, or does it not?" You don't like the word "retaliation" yourself; you are seeking something else. Senator Baucus asked you about other forms of pressure, and frankly you didn't give him an answer. So, doesn't it come down to this dilemma—and I would ask your or anybody else's philosophical response to this—we are not getting the attention of the Japanese. We are not doing it by the actions that we are taking; we are obviously not getting it by actions that we are not taking. Therefore, 301 being a very powerful tool, 301 with mandatory retaliation being an even more powerful tool, what about mandatory retaliation.

Now, maybe the point isn't retaliation, per se, which goes to Senator Packwood's point, but maybe it is the fact that we have to do something in this country which so catches the attention of the Japanese and others that they understand that they have to negotiate, henceforth, with a new intensity and new flexibility. Retaliation may not be something for the long term, but trade relations can only work for the long term if we use it for the short term—that is, if in the first, second, third and fourth cases that come up under 301 we take serious action on the very clear prospect of action. Then the Japanese will understand that we are serious—going back to what you said.

You know, if we pass a textile bill, the President vetoes it, and we can't override it; what kind of dance would we be going through this year? How do the Japanese see us? How do and others—the newly industrialized countries and others—see us getting serious about trade policy? Isn't that really what the argument about retaliation is about?

Mr. **Prestowitz**. To a large extent I think it is, Senator.

I think that Japan and others—not just Japan—have seen us cry wolf for so long that it just doesn't have any effect anymore. If we are going to have any useful kind of negotiation, there has to be a belief on their side that the game has changed, and that is what retaliation gives you.

Senator **Rockefeller**. May I ask you, then, is there any other approach to 301 that we can take—nobody particularly wanting to retaliate?

Mr. **Prestowitz**. Let me just suggest something. Again, as I say, the retaliation, as you say, is beside the point. Let me suggest this: I said earlier to Senator Packwood that first of all there are some countries like Japan who don't really know what "open" is. I mean, I have negotiated with Japanese who I thought were being sincere in trying to open their market but they couldn't do it because they didn't really know what to do.

Second, there are some industries which are non-negotiable. Now, the premise of 301 is that markets are free or should be, and that governments can open their markets by taking some definitive steps, and that if they don't do that they are cheating and therefore you ought to shoot them. But if it were possible for us to encompass in 301 the concept that there may be some instances where governments, even if they are sincere, can't open their market, and there may be some industries which we know we can't negotiate over, let us define the criteria that define those governmental circumstances or those industries, and let us say, "Okay, we know that if an industry or a government meets these and these and these criteria, that really we can't negotiate this thing; it is not going to work; it is like airlines or like negotiating with the Russians—we don't apply the rules of free trade with the Russians, because we know the system can't encompass them."

So if we could create a category in 301 and say, "Okay, there are some circumstances that just aren't market circumstances, and the normal rules don't apply, and in those circumstances we are going to put them in a different category. We will call that category the Airline Category or the Bloc Category, or whatever it is. In that category, we are going to negotiate these things differently, tit-for-tat, reciprocity. We are not going to retaliate, but we are just going to tell them, 'Okay, look, France, we know you want to make Airbuses, and we know you are going to do that; so fine, go ahead, but just don't expect to sell any more Airbuses here than we sell airplanes over there.' "

That is obviously a somewhat simplistic approach, but what I am trying to do is to get to a differentiation of law which is based on the real differentiations in the market.

The fact is, as I said, we do not apply the rules of the GATT or the OACD to the Soviet Bloc. We trade with it, but we don't apply those rules, because we know we can't accommodate that system with our rules; it is a different system.

The problem is that we define everything in black and white—all the Russians are black, and all the rest of it is free market. But everything else is not free market. The Japanese market is not as open a market as the Canadian market. The French market is not as open a market as the German market. It is a spectrum. The closer we get to the spectrum of our own market and our own procedures, the easier it is to apply these rules. The further away we get, the more difficult it is. We can accommodate, obviously, a certain amount of difference between ourselves and others, but there is some point in which the difference becomes so great you just can't accommodate it.

I would like to try to define what that point is, and then deal with it, and deal with it in a non-retaliatory, non-cheater-unfair framework but rather in a realistic framework of, "Okay, we understand how you are, and that's fine; just be the way you are. But you have to understand, then, that we have to deal with you in a different way."

Senator ROCKEFELLER. Thank you, Mr. Chairman.

Ms. HAGGART. Mr. Chairman, may I just take two seconds to respond to Senator Rockefeller's comments on the cellularr situation?

The CHAIRMAN. Yes, Ms. Haggart. We are running late so, if you will, keep it very short.

Ms. HAGGART. Thank you. Let me just say, Senator, that we appreciate your and others on this Committee's continuing concern on this issue, and it has been a difficult problem for us. We did, about the time Mr. Galvin was here, received word of a decision, as you indicated, that we felt was inequitable. With the help of our negotiators, we have since continued to press on this issue, and we are hopeful of a better outcome. We will keep you apprized of any further developments.

Thank you.

The CHAIRMAN. I think it has been a very interesting discussion, and it shows the complexities of the problem and how difficult it is to deal with it. But these have been contributions, and we are appreciative of your attendance.

Each of you will have his comments taken in full for the record, as far as you have submitted written comments. We will have one more witness, Mr. Mendelowitz from the General Accounting Office. Thank you so much for your attendance.

Mr. Mendelowitz is the Senior Associate Director of the General Accounting Office. If you will come forward, please.

STATEMENT OF ALLAN MENDELOWITZ, SENIOR ASSOCIATE DIRECTOR, U.S. GENERAL ACCOUNTING OFFICE, WASHINGTON, DC

Mr. MENDELOWITZ. Mr. Chairman, I have a short statement I would like to submit for the record and, with your permission, I will read an even shorter statement, in the interest of time.

The CHAIRMAN. Go ahead.

Mr. MENDELOWITZ. I am pleased to be here today to summarize our report to this committee entitled "Combating Unfair Foreign Trade Practices." Our report focuses specifically on Section 301 of the Trade Act of 1974.

We examined the overall 301 process and its record of success in remedying unfair foreign trade practices. We also documented the experiences of 301 petitioners in our analysis of all 35 petitioner-initiated Section 301 cases that were pending or initiated between January 1, 1980 and December 31, 1985. Twenty-three of these cases were taken to the GATT for resolution under the GATT dispute settlement process, and 12 cases were negotiated bilaterally. In addition, we analyzed the four cases self-initiated by the Office of the U.S. Trade Representative during this period.

Overall, we found that the use of Section 301 had limited success in achieving the removal of unfair foreign trade practices. Although its broad scope is adequate to address such practices, the Section 301 process has generally been very lengthy, particularly when complaints must also go through the GATT dispute settlement process. Both petitioners and government officials involved in this process expressed great concern about its length.

The length of the 301 process varied dramatically. GATT cases averaged much longer than bilaterally negotiated cases. Overall, the cases averaged 34 months in duration—that is almost three years—with GATT cases averaging 45 months and non-GATT cases 13 months. We note these averages will ultimately be longer, because they include cases that were not terminated as of June 1, 1986, the cutoff date for our analysis.

Despite the fact that the GATT dispute settlement process lacks any binding deadlines, U.S. practice has generally been to allow this process to formally conclude before any retaliatory Presidential action is taken. The one exception to this was the citrus dispute with the European Community, which prompted unilateral action by the United States.

In our interviews, petitioners often expressed dissatisfaction with the 301 process, citing specifically the length of time involved in most cases. Those involved in GATT cases generally voiced the most dissatisfaction, and several petitioners told us that they would not attempt to use this provision again, especially if it meant going through the GATT dispute settlement process. Petitioners generally advocated stricter domestic and international timeframes for the settlement of cases. Further, petitioners expressed concern regarding the results of completed cases, the development of evidence, the amount of "political will" to resolve 301 cases, and the long-range impact of negotiated agreements.

With regard to results, the U.S. Government generally views success in 301 cases as the removal of the unfair foreign trade practice. However, during the period of our study, relatively few cases resulted in the elimination of the specified unfair practices. Three petitioners told us that the Section 301 process had remedied the unfair foreign trade practice completely; 20 reported that the process had had no net effect on the practice or that the foreign country had replaced the practice with another restrictive practice; and 12 stated that it had remedied the practice partially.

In addition to eliminating unfair trade practices, petitioners also want the resulting injury eliminated. Eleven of the 35 petitioners reported that the trade injury cited in their complaints was remedied either completely or partially by the disposition of the cases, but two-thirds—that is 23 of the petitioners—felt that there was no net effect on the injury cited. Of those petitioners that reported the unfair practice was partially remedied, half also indicated that the injury remained unchanged or in fact had become more severe.

Trade experts, Administration officials, and petitioners alike advocate the need for a more effective dispute-settlement mechanism. The Administration has set improvement of the GATT dispute-settlement process as a primary objective in multilateral trade negotiations. We agree that only in this forum can the dispute-settlement process be improved and its value realized. However, because the anticipated GATT negotiations will be protracted, we believe that a uniform mechanism is needed now to limit the length of U.S. participation in GATT dispute settlement for Section 301 cases.

We therefore are recommending that the Congress amend Section 301 of the Trade Act to require that OUSTR set a date for each Section 301 case involving the GATT, at which time the United States would be expected to withdraw from the GATT dispute-settlement process if it is not completed. In consideration of the complexity and sensitivity of each case, we believe that this amendment should give OUSTR some flexibility in setting a deadline.

We believe that the Administration's proposal for an OUSTR recommendation to the President after 24 months in such cases does not represent a genuine limit on U.S. participation in protracted 301 cases.

Mr. Chairman, this completes my summary, and I will be happy to try to answer any questions you might have.

[Mr. Mendelowitz's prepared statement follows:]

STATEMENT OF
ALLAN I. MENDELOWITZ
SENIOR ASSOCIATE DIRECTOR
NATIONAL SECURITY AND INTERNATIONAL AFFAIRS DIVISION

Mr. Chairman and Members of the Committee

We are pleased to be here today to summarize our report to this Committee, entitled "Combating Unfair Foreign Trade Practices." Our report focuses specifically on Section 301 of the Trade Act of 1974, which, as you know, gives the President broad powers to enforce U.S. trade rights. Section 301 is, in fact, the primary provision of U.S. trade law that authorizes the U.S. government to act against unfair trade practices that restrict U.S. access to foreign markets. As such, it has been called a "key weapon" in the administration's "trade arsenal."

We examined the overall 301 process and its record of success in remedying unfair foreign trade practices. We also documented the experiences of 301 petitioners in our analysis of all 35 petitioner-initiated section 301 cases that were pending or initiated between January 1, 1980, and December 31, 1985. Twenty-three of these cases were taken to the General Agreement on Tariffs and Trade (GATT) for resolution under the GATT dispute settlement process, and 12 cases were negotiated bilaterally. In addition, we analyzed the 4 cases self-initiated by the Office of the U.S. Trade Representative (OUSTR) during this period.

Overall, we found that the use of section 301 had limited success in achieving the removal of unfair foreign trade practices. Although its broad scope is adequate to address such practices, the section 301 process has generally been very lengthy, particularly when complaints must also go through the GATT dispute settlement process. Both petitioners and government officials involved in this process expressed great concern about its length.

Length of process

The length of the 301 cases we analyzed varied dramatically, with GATT cases averaging much longer than bilaterally negotiated cases. Overall, cases averaged 34 months in duration, with GATT cases averaging 45 months and non-GATT cases 13 months. We note that these averages will ultimately be longer because they include cases that were not terminated as of June 1, 1986, the cutoff date for our analysis.

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Petitioner's experiences

In our interviews, petitioners often expressed dissatisfaction with the 301 process, citing specifically the length of time involved in most cases. Those involved in GATT cases generally voiced the most dissatisfaction. Several petitioners told us that they would not attempt to use this provision again, especially if it meant going through the GATT dispute settlement process. Petitioners generally advocated stricter domestic and international time frames for the settlement of cases. Further, petitioners expressed concern regarding the results of completed cases, the development of evidence, the amount of "political will" to resolve 301 cases, and the long-range impact of negotiated agreements.

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Improvements to dispute settlement sought

Trade experts, administration officials, and petitioners alike advocate the need for a more effective dispute settlement mechanism. The administration has set improvement of the GATT dispute settlement process as a primary objective in multilateral trade negotiations. We agree that only in this forum can the dispute settlement process be improved and its potential value realized. However, because the anticipated GATT negotiations will be protracted, we believe that a uniform mechanism is needed now to limit the length of U.S. participation in GATT dispute settlement for section 301 cases.

We, therefore, are recommending that the Congress amend section 301 of the Trade Act of 1974 to require that OUSTR set a date for each section 301 case involving the GATT at which time the United States would be expected to withdraw from the GATT dispute settlement process if it is not completed. In consideration of the complexity and sensitivity of each case, we believe that this amendment should give OUSTR some flexibility in setting a deadline.

In response to our report, OUSTR cited the aggressive stance it has taken over the past 18 months in addressing section 301 cases, specifically the self-initiation of cases as well as a variety of other 301-related actions which it characterizes as producing successful results throughout fiscal year 1986.

OUSTR was also concerned that our recommendation would require the United States to withdraw prematurely from GATT dispute settlement and that it might be unwise to preclude continuation of these proceedings. OUSTR advised us that the administration has proposed that a 24-month deadline be set for OUSTR's recommendation to the President in dispute settlement cases. OUSTR could recommend continuing U.S. participation in the GATT process, withdrawing from it, or taking other actions.

The administration's proposal does not set a firm deadline to end U.S. participation in protracted GATT dispute settlement cases. In the past, GATT cases for which OUSTR recommendations were required have been followed by Presidential determinations to continue U.S. participation in the GATT process. Such section 301 cases have often gone on for years without resolution. We believe that a firm deadline for U.S. withdrawal from the GATT process is necessary to bring such cases to closure. Consequently, we recommend that at the time each case is referred to the GATT, a firm deadline be established for ending U.S. participation in the GATT dispute settlement process.

Mr. Chairman, this concludes my statement. I will be happy to answer any questions you and other members may have at this time.

The CHAIRMAN. Mr. Mendelowitz, when you make that recommendation that if it isn't completed in a period of time, do I understand you to state that you recommend, then, that the U.S. withdraw from it?

Mr. MENDELOWITZ. That is correct.

The CHAIRMAN. And what is accomplished by that?

Mr. MENDELOWITZ. Our experience has been that when we looked at the 301 cases that had gone to the GATT, each stage of the GATT process was drawn out.

The CHAIRMAN. Well, if you withdraw, what do you accomplish by withdrawing.

Mr. MENDELOWITZ. I think the major accomplishment of having a deadline at which time we would be expected to withdraw is that it would focus the attention of the participants on reaching closure in the dispute.

The CHAIRMAN. Let us suppose they don't want to resolve it and you withdraw, what have you gained? That is what I don't understand. Explain that to me.

Mr. MENDELOWITZ. I think that there are circumstances when unilateral action is appropriate.

The CHAIRMAN. Are you then stating that you withdraw, and you take action on your own?

Mr. MENDELOWITZ. That is correct.

The CHAIRMAN. Would you not be in a position of us being in violation of the GATT if you did that?

Mr. MENDELOWITZ. I think that clearly if you withdraw from the GATT dispute-settlement process and take unilateral action that has not been sanctioned by the dispute-settlement process, the question of being in violation of the GATT definitely rises. But I think, against that concern, we have to balance the fact that the dispute-settlement process has been used, I think, to draw out and prevent these disagreements from reaching closure. And because there has been no action-forcing mechanism——

The CHAIRMAN. I don't question but what, in some instances the participants have stalled the process; they may not want a resolution of the problem.

Mr. MENDELOWITZ. Correct.

The CHAIRMAN. Senator Packwood.

Senator PACKWOOD. I want to follow up on Senator Bentsen's question. If you give GATT 24 months to resolve the case, they don't resolve it, and we therefore withdraw the issue from them; we may or may not be in violation of GATT, but in essence we are saying: "To heck with that." We are not necessarily recommending mandatory action under 301; we are simply saying, "Well, then, go on and do whatever our laws allow and whatever our processes decide, absent GATT"?

Mr. MENDELOWITZ. That is correct. I would say that there are three options. One option is that we decide the problem is so intractible and other considerations are so great that we choose to do nothing. A second option is that we pursue direct bilateral negotiations on an intensive basis in an effort to try to resolve the issue. The third option is that we might choose to take unilateral action. The latter case would of course raise the issue of our compatibility with the GATT.

Senator PACKWOOD. If I can paraphrase what you are saying, you are saying GATT drags too long. We ought to set a deadline within reason, and you would give the USTR some discretion as to that deadline. In some cases it might be 18 months, in others it might be 30. But you would have a deadline at the start.

Mr. MENDELOWITZ. That is correct.

Senator PACKWOOD. When the deadline arrives, the USTR may take no action. He choose to opt out at that stage.

Mr. MENDELOWITZ. Senator, I had the opportunity to observe the negotiations at Punta del Este at the GATT Ministerial, and the negotiations dragged out for about a week. They started on Sunday, and along about Friday afternoon the general consensus was that very little progress had been made, and there was real concern about whether anything would come out of those negotiations at all.

The U.S. Delegation then announced that, whether there was agreement or there wasn't agreement, the U.S. Delegation was going to depart on Saturday morning, and the plane was scheduled to leave at 11:00.

Intensive negotiations followed, and lo and behold somewhere around between Midnight on Friday night and 5 a.m. on Saturday morning we managed to come up with an agreement that the U.S. Delegation was very proud of.

So I think that having a firm deadline adds a certain urgency to the negotiations and helps to bring them to closure.

Senator PACKWOOD. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Rockefeller?

Senator ROCKEFELLER. Mr. Chairman, I have no questions.

The CHAIRMAN. Mr. Mendelowitz, thank you very much for your testimony.

Mr. MENDELOWITZ. Thank you, Mr. Chairman.

[Whereupon, at 12:49 p.m., the hearing was adjourned.]

[By direction of the chairman the following communications were made a part of the hearing record:]

PETE V. DOMENICI
NEW MEXICO

United States Senate
WASHINGTON, D.C.

March 17, 1987

The Honorable Senator Lloyd Bentsen
703 Hart Senate Office Building
Washington, D.C. 20510

Dear Lloyd:

Today, you will be hearing testimony on the unfair trade practices of our trading partners. The trade situation has caused considerable damage to many industries in the state of New Mexico and throughout the United States. Clearly, it is time to deal with the unfair practices of our trading partners and to take steps to improve enforcement of our trade agreements.

I am particularly concerned about the practice of subsidizing excess productive capacity for fungible goods like copper. Over the years, our domestic producers have worked hard to reduce their costs and to increase their productivity. However, we cannot expect them to compete with foreign-government subsidies. Fungible goods, because they are not unique, are truly world commodities, traded in world markets. Subsidized excess capacity overseas leads to worldwide high inventory levels and extremely low prices. Such conditions make it impossible for our producers to compete in the near term and to raise capital for future operations. We should not stand by while subsidized producers in other countries force our producers out of business.

On March 9, the Wall Street Journal featured an article on this same subject. It points out that many debt-laden countries have invested in capacity to produce commodities for export, to produce cash at any price. The article is timely and the information bears directly on the trade issues before this committee. I am enclosing a copy of the article for your review.

The Trade Act of 1974 should be amended to address this issue. I suggest Section 301(e)(3) be amended to specify that the term "unreasonable practice" includes any act, policy, or practice which provides, directly or indirectly, monies on terms inconsistent with commercial considerations to increase capacity of a fungible good, if this subsidized capacity would contributed to world overcapacity (existing or reasonable expectation of the future) for that good.

Senator Bentsen
March 17, 1987
Page 2

As you consider amendments to the trade laws, I urge you to give careful consideration to ways to correct this serious problem of subsidized overcapacity. In addition to opportunities to amend Section 301 of the Trade Act of 1974, there is a need for similar provisions in our objectives for negotiating trade agreements and participating in multilateral development bank decisions. I am planning to introduce legislation in the near future to deal specifically with these issues. The subsidization of excess capacity is an unreasonable practice, just as industry targeting or export subsidies are unreasonable and unfair to our industries.

Thank you for your consideration.

Pete

PETE V. DOMENICI
United States Senator

Enclosure

THE WALL STREET JOURNAL

Monday, March 9, 1987

Glutted Markets

A Global Overcapacity Hurts Many Industries; No Easy Cure Is Seen

Among Those Hit Are Autos, Steel, Computers, Chips; Some Chemicals Recover

One Winner: The Consumer

A WALL STREET JOURNAL *News Roundup*

Raise the subject of America's industrial problems, and you hear a lot of complaints. You are told that much of U.S. industry is performing sluggishly because Americans don't want to work anymore or have forgotten how; that foreign rivals are competing unfairly through government machinations, ridiculously low wages or both; that the U.S. just hasn't surmounted the legacy of an overvalued dollar.

But all this emphasis on what is going wrong in the U.S. and in its relations with trading partners—especially Japan, with its mercantilist drive to export—tends to obscure a world-wide problem: Many major industries, all around the globe, are burdened with far too much capacity.

"Overcapacity is a world-wide problem, and it's getting worse," says Lester Thurow, an economist at the Massachusetts Institute of Technology. "We're still investing as if the world economy were growing at 4% a year instead of the actual rate of about 2%."

Demand Sluggish

While a lot of automated capacity has been added, effective demand has been sluggish. Knocking many buyers out of the market have been the debt burdens in Latin America, the political and economic slide of much of Africa, and the torpor of most Communist economies.

Even then, the forces of supply and demand should, theoretically, produce prices that clear the markets. But they seem not to be doing so, or are working only slowly and painfully, partly because of protectionism, government subsidies and other forms of political interference with the process of economic adjustment. In many industries, moreover, declining prices have rendered

Not everyone is rattled by the overcapacity, however. Marvin Runyon, a former Ford executive who runs Nissan's plant in Smyrna, Tenn., says: "You read that we're putting too much capacity in place, but that's the way it has to be in a competitive industry. I say hooray for the American consumer, because somebody is going to have to do things better than somebody else. The consumer will benefit."

Many Industries Afflicted

Whether good or bad, overcapacity is obvious in many industries. Among them:

Autos. Roger Vincent, an expert at Bankers Trust Co., estimates that world automotive demand stands in the "low 30 millions" of vehicles annually, while capacity "is in the low to mid-40s." By 1990, capacity should rise to the mid-40s, he says, and demand won't grow very much. Thus, world overcapacity could expand to about 15 million units from about 10 million currently, he believes.

Steel. Estimates vary, but most economists calculate the annual global overcapacity at 75 million to 200 million metric tons—compared with total capacity of 578 million tons in non-Communist countries and 455 million tons in industrialized nations. John Jacobson, an economist at Chase Econometrics, figures that only if the entire U.S. steel industry shut down would demand equal supply in the non-Communist world.

Computers. Although no figures on the industry's capacity use are published, most computer makers are clearly being plagued with overcapacity. The problem is reflected in declining orders and intense competition.

Semiconductors. In the U.S. and Japan, which together account for 87% of global chip making, the equipment-use rate—the best measure of overcapacity—skidded from nearly 100% in 1984 to about 60% in 1985. However, Dataquest Inc., a market-research firm, says it is now back up to roughly 70% and rising.

Heavy Equipment. Makers of farm and construction equipment are buried in overcapacity, but, surprisingly, some countries, especially South Korea, are nonetheless believed to be planning more plants.

Textiles. In the textile industry, cheap-labor foreign competition is causing the howls. Overcapacity lingers on as more and more mills are built in less developed nations, with more and more mills in the U.S. thus turned into surplus capacity.

Rebound in Chemicals

However, some once-glutted industries have got supply and demand back into balance. For example, much of the chemical and plastics group has cut capacity and expanded sales, and the glut of a few years ago has been largely cured.

Looking at many troubled industries, Joseph L. Bower, a Harvard Business School professor, attributes much of the excess capacity to "country after country building world-scale facilities." Newly industrializing countries have ample reason for fostering development, of course. They want to create industrial jobs at a time of rapidly expanding populations, of an influx into the cities and of rising educational levels, which create labor forces sufficiently skilled for factory work. The weakness in many commodity markets also encourages the idea that any hope for economic growth lies in industry.

Industrialization has been rapid, Mr. Bower adds, "because technology and capital are now highly mobile—it's staggering how fast they can move around the world nowadays." No longer, he says, is the game played by "just four or five good players." He urges that American companies "understand that we've moved from Ivy League football to the Big Ten."

Many economists trace the overcapacity back to the booming early 1970s, when many manufacturers saw tremendous growth in demand ahead and expanded accordingly. Other analysts go back much further. Jay W. Forrester, also of MIT, traces the problem—which he thinks will get worse—largely to "the big buildup of capacity during and after World War II." He recalls that "the idea took hold that more capital plant was invariably desirable," and building it was facilitated by "the enormous forced savings that had accumulated during the war years."

Also greasing the path to industrial overcapacity are plentiful supplies and low prices of many raw materials—an incentive for marginal manufacturers to keep producing and for newcomers to enter the game. The gluts affect a wide range of commodities. For example, producers of nickel and molybdenum, both used in producing steel, are operating at roughly 70% to 75% of capacity world-wide, estimates Robin Adams, the president of Resource Strategies Inc., a consulting firm in Exton, Pa. The copper industry is operating at a little over 80% of capacity, he adds.

The stage for the commodity gluts was set in the inflationary 1970s, when price shocks stimulated investment in production capacity in many commodities. But in many cases, demand hasn't grown to meet the increased production.

Pressure to Produce

Moreover, many debt-laden countries increased the output of commodities to avoid spending precious foreign exchange on imports. Others invested in commodity-producing capacity to generate export cash regardless of price. Many countries "only had one option, and that was to produce more. So we didn't follow the normal corrective path," says Donald Ratajczak, the head forecaster at Georgia State University. Copper, for example, has responded slowly to reduced demand.

Oil is abundant, too. The Organization of Petroleum Exporting Countries is producing less than 15.8 million barrels of oil a day, compared with capacity of nearly 30 million. However, the surplus is mainly in crude oil—both in the ground, in production capacity, and above it, in inventories. In petroleum refining, much of the overcapacity has been trimmed back. U.S. refineries are operating at about 80% of capacity, a relatively high level, and as gasoline demand rises, processing facilities may be approaching their effective limits.

But the oil-service sector remains awash in red ink. After the collapse in petroleum prices last year, oil companies slashed exploration and production spending by 40% to 50%. This year, spending remains depressed. Thus, only 25% of the U.S. drilling-rig fleet is active, and manufacturers of oil-field equipment have several times the capacity currently needed.

Here is a detailed look at the overcapacity problems in major industries.

Autos

Automotive experts agree that the industry suffers from vast overcapacity world-wide and that Japan, like North America and Europe, will soon be hit as it builds more U.S. plants. But they disagree about the extent of the overcapacity; some measure cars, for example, and others measure all vehicles.

Ford, which gauges capacity quite differently from Bankers Trust, estimates 1985 world-wide overcapacity at 3.8 million cars and trucks, and it believes that by 1990, world-wide excess capacity will rise to six million units, 5.7 million of which will be aimed at North America.

The principal force behind the projected increase is the expansion of Japanese auto manufacturing. The Japanese, having pushed aggressively into the U.S. auto market, are reacting to the voluntary export restraints and the threat of more American protectionism. "The building of Japanese plants in the U.S. wasn't motivated by economics," Bankers Trust's Mr. Vincent says. "It was motivated by concern over future protectionism."

As a result, the auto glut bedeviling the U.S. industry is being worsened. Starting in 1989, Daihatsu Motor will be producing cars in Canada, thus becoming the last of Japan's nine auto makers to put an assembly plant in North America.

Meanwhile, other players keep getting into the game. In the wake of the success of South Korea's Hyundai Excel, Kia Motors of Korea is planning to export cars and vans world-wide by the end of this decade. Yugoslavia is exporting its Yugos to the U.S., and Malaysia plans to send its Proton Sagas here next year. Thailand and Taiwan also are trying to export.

"Newly industrialized countries all want auto companies so they can have steel industries and reasons to build roads and purchase technology from the outside world," says Susan Jacobs, the manager of automotive research at Merrill Lynch Economics Inc.

However, she also attributes the excess capacity to sluggish world-wide demand. In addition, she says, new plants were built to make the small cars that became popular during the energy crisis of the 1970s and to enter new market niches, such as that for light trucks.

Japanese Auto Makers

A comprehensive listing of Japanese companies that build cars in North America or are planning production:

COMPANY	YEAR: TOTAL CAPACITY
Honda of America Marysville, Ohio	1986: 220,000
Nissan Motor Mfg. U.S.A. Smyrna, Tenn.	1986: 65,690
Toyota Motor Mfg. U.S.A.[1] Fremont, Calif.	1987: 50,000
Georgetown, Ky.	1988: 75,000 1989: 200,000
Mazda Motor Mfg.[2] Flat Rock, Mich.	1988: 135,000 1989: 240,000
Diamond Star Motors[3] Bloomington-Normal, Ill.	1989: 182,400
Daihatsu Motor[4] Valcourt, Que.	1989: 37,200
Isuzu-Subaru Lafayette, Ind.	1990: 240,000
Suzuki/GM Ingersoll, Ont.	1990: 200,000

[1] Joint venture with General Motors
[2] Joint venture between Mazda and Ford
[3] Joint venture between Mitsubishi Motors and Chrysler
[4] Joint venture with Bombardier

Source: Chase Econometrics

Japan hasn't had more automobile start-up companies than Europe or the U.S., Mr. Vincent says. "It's just that they all managed to survive"—with government help. Other nations have done much the same, however. The U.S. government saved Chrysler. And Donald Petersen, Ford's chairman, notes the heavy French subsidies for Renault and American Motors and says he expects the two French producers, Renault and Peugeot, to survive "as long as there is a France."

Japan and South Korea also have stimulated their auto industries by closing their home markets to outsiders and encouraging exports. Moreover, the Japanese also have helped South Korea develop its auto industry. Mr. Vincent believes that the Japanese are saying, "It's inevitable, and why not be part of it?"

Mr. Vincent notes that in the past, American auto companies, looking forward to the next auto-buying boom, often created excess capacity. If the market grew, "you are bailed out by higher demand; otherwise, you get stuck with overcapacity—which is what has happened to some companies," he says.

But the patterns have shifted. Ford reacted to flatter demand by changing its philosophy—keeping capacity tight, forgoing some sales but betting that lower capacity would cut costs and keep it profitable when demand fell. But until recently, General Motors kept more capacity running than its sales warranted. Now, however, GM also is closing more plants.

James P. Womack, the research director of the international motor-vehicle program at MIT, believes that apparent world overcapacity might not be as large as it seems because "some plants are dedicated [to a certain type of vehicle] and can't be switched from product to product." While the Japanese have built flexible plants that can make more than one vehicle, he says, "the North American philosophy has been not to complicate matters by mixing products"—a policy that aggravates the overcapacity.

Steel

The global glut of steel reflects poor investment decisions in the 1970s, dwindling use of steel in industrialized economies, burgeoning production in industrializing countries, and high financial and political barriers to closing mills.

Anticipating shortages, steelmakers in Europe and Japan greatly expanded capacity in the 1970s, and U.S. producers modernized existing mills. Not only did scarcity never come, but consumption fell sharply in industrialized countries. Between 1970 and 1980, according to the World Bank and International Iron and Steel Institute, capacity in industrialized nations climbed 14% to 485 million metric tons, while consumption dropped 8% to 334 million metric tons.

Yet despite mounting evidence of a "phony boom," steel executives "just wouldn't give up the illusion that the market was headed up," says Hans Mueller, a steel-industry consultant.

Plunging consumption in industrialized nations, which is expected to continue into the 1990s, reflects the maturation of their economies. Construction of railroads and highways has largely been completed. And in other big steel markets—autos and containers, for example—alternative materials are increasingly supplanting steel. Donald F. Barnett, a World Bank consultant, calculates that had U.S. steel usage since 1960 matched the growth in gross national product, steel consumption in 1985 would have been some 70% higher.

Faced with excess capacity, European and Japanese steelmakers, in particular, have turned to export markets. But there they are increasingly finding limits. U.S. producers have won import curbs, and less developed countries, though consuming more and more steel, are producing much of it themselves.

Some, moreover, are becoming major exporters, penetrating traditional European and Japanese export markets. In 1976, Brazil, for instance, produced 7.3 million metric tons of steel products and exported a mere 261,000 tons. Today, it is the world's fifth-largest non-Communist steelmaker, and it exported 40% of the 17.3 million tons it produced in 1985.

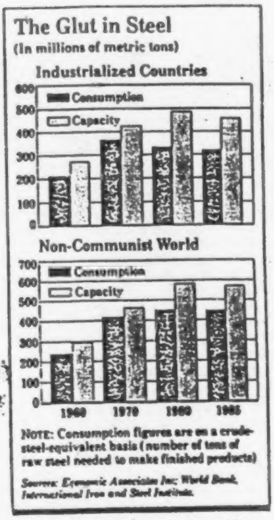
Rapid growth in steelmaking capacity may have as much to do with nationalism and industrial prestige as economic growth. Today, Zimbabwe and Qatar have steel industries. "Every industrializing country wants an airline and a steel mill," Chase's Mr. Jacobson says. "It's something that planning ministers push for."

Capacity has fallen modestly among industrialized nations since 1980, and the reductions are continuing. In the U.S., steelmaking capacity (including recently announced cutbacks) is being slashed to 111.9 million short tons from its 1977 peak of 160 million tons. Even with the cutbacks that have been carried out, the U.S. industry is operating at only 55% of capacity, Georgia State's Mr. Ratajczak estimates.

In Japan, all five major steelmakers are cutting production capacity, although only one, Nippon Steel, has specified its plan in terms of crude steel-production capacity; it is cutting back to 24 million metric tons annually from 34 million tons.

Louis L. Schorsch, a consultant at McKinsey & Co., expects future mill closings to be much more difficult. In the U.S., many steelmakers, saddled with huge unfunded pension liabilities, are reluctant to shut even unprofitable plants because they can't absorb the cost of paying off workers and other expenses. Chase Econometrics estimates the total cost of closing a mill at $75,000 per employee. "Given an average of 4,000 employees per plant," Mr. Jacobson says, "we estimate that a typical integrated-plant closure today would cost over $300 million."

Mr. Barnett adds: "So far, steelmakers have closed mostly old plants that hadn't been in operation anyway. Now, they've got to get rid of relatively modern capacity that can still make a satisfactory product. The hard part is just beginning."



The Glut in Steel

(In millions of metric tons)

NOTE: Consumption figures are on a crude-steel-equivalent basis (number of tons of raw steel needed to make finished products)

Sources: Economic Associates Inc; World Bank, International Iron and Steel Institute.

Computers

Seduced by huge sales gains during the 1983-84 boom, computer companies expanded rapidly. Most "invested in growth rates that aren't materializing," says Ulric Weil, a Washington-based securities analyst. "Demand just didn't develop." According to Commerce Department figures, factory orders for the office-equipment and computer industry plunged 15% in the two-year period ended in 1986.

A good barometer is International Business Machines, which accounts for 40% of the world's computer sales. Last year, IBM's revenue rose only 2% to $51.25 billion, and profit slumped. This isn't the type of growth IBM anticipated. In the past five years, IBM spent more than $20 billion on

IBM responded to last year's disappointments by consolidating operations at several U.S. locations "to bring capacity in line with current and projected needs," IBM Chairman John Akers said in the company's 1986 annual report.

Nevertheless, many computer makers expanded in the fight for sales. "People who participated in niches in the past want to expand and provide complete systems for their customers," says David Penning, the director of manufacturing-automation service at Dataquest. For instance, he adds, some personal-computer companies now make work stations, while some computer makers best known for mainframes make personal computers.

Technological advances have aggravated the overcapacity. With more power being stored on silicon chips, computer companies can make smaller, more powerful machines. "Any given square footage of plant can produce a lot more stuff in terms of horsepower," Mr. Weil says. The minicomputer market is being squeezed from two sides: on the lower end, by more powerful personal computers, and on the upper end, by lower prices on computers with the power once associated with mainframes.

The emergence of manufacturers in the Far East, especially those in Japan and South Korea, has compounded the overcapacity problem for U.S. computer makers. Last year, the U.S. computer and parts trade deficit with Far Eastern countries soared 77% to $5.3 billion, according to the Commerce Department. Japan's exports to the U.S., ranging from parts to portable

Defining Overcapacity Is A Very Tricky Proposition

By a WALL STREET JOURNAL *Staff Reporter*

Industrial overcapacity is a little like pornography: You may know it when you see it, but defining it precisely is a slippery proposition.

"Capacity is an ambiguous term. What is 'excess'?" comments Alan Greenspan, a New York economic consultant. "Excess capacity doesn't mean anything without cost considerations."

He adds: "Capacity can be called excess only when it doesn't fit its environment. When capacity doesn't fit, we get rid of it and replace it with capacity that does." He says a lot of obsolete, high-cost or redundant industrial capacity "should be written down, but companies haven't done it."

Statistics on overcapacity are tricky partly because the problem is strongly affected by the business cycle. A plant unneeded during a recession may become a productive asset again during an economic boom; in a boom, prices rise, and high-cost productive capacity may be competitive. Figures also are scarce because many industries turn out such a wide range of products that overcapacity can't be quantified on an industry-wide basis. And many companies, fearful of divulging information useful to personal computers to supercomputers, surged 43% to $4.75 billion last year.

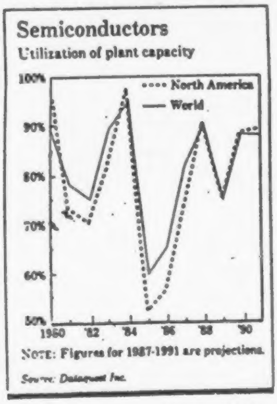
Moreover, countries that had primarily produced peripherals are exporting full machines now, says Tim Miles, a program manager in the department's Office of Computers. "The South Koreans began penetrating the U.S. market in terminals and other areas," Mr. Miles says. "Now, they're producing complete PC systems."

Not all computer makers have been suffering, however. Some companies, such as Tandy Corp., which makes personal computers, and Digital Equipment Corp., a minicomputer maker, have grown rapidly, primarily because of revamped product lines. Moreover, the pressure on the industry would be reduced by any pickup in sales. Already, there are signs of rebounding volume in personal computers.

Semiconductors

The glut in the semiconductor industry eased last year, as orders picked up from a disastrous 1985, but most chip makers remain deeply troubled. The roots of the problems are twofold: Huge miscalculations of future demand and Japanese producers' targeting practices, under which they ignored market conditions while aggressively pursuing market share.

The introduction of the personal computer early this decade spawned a sudden surge in demand for chips. Global chip consumption jumped from about $15 billion in 1982 to $29 billion in 1984. Thus, chip makers rushed to add capacity to meet growing, apparently insatiable demand. Japanese chip makers' capital spending rose a total of 116% in 1983 and 1984, while U.S. chip-company spending doubled in 1984. World-wide capacity to produce chips increased about one-third in 1984 alone.



Semiconductors

Utilization of plant capacity

NOTE: Figures for 1987-1991 are projections.

Source: Dataquest Inc.

Then, when falling personal-computer sales sent global chip demand plummeting about 14%, to $25 billion, in 1985, chip companies started losing big money. Dataquest says the chip industries in Japan and the U.S. each lost about $1 billion last year.

Moreover, Japanese producers exacerbated the industry's overcapacity problems by continuing to add production and slash prices on certain products right through the slump. Taking advantage of their lower-cost capital, patient stockholders and government research assistance, the Japanese drove U.S. producers out of some major commodity markets by drastically underselling them.

Indeed, the U.S. government found that Japanese companies "dumped" certain chips in the U.S. and other markets, and the U.S. may soon penalize them if they don't raise their prices. Japan's Ministry of International Trade and Industry, trying to save a semiconductor trade pact signed last summer, has told Japanese chip makers to cut production 10%.

Heavy Equipment

Plunging demand has blighted the farm-equipment industry with huge world-wide overcapacity. The glut has persisted despite sharp cutbacks in the number of factories producing tractors, combines and other agricultural equipment.

Sales have consistently trailed even the most pessimistic forecasts. In retrospect, that isn't surprising. The world is awash in food. A few years ago, fears of shortages, embargoes and price gouging led many food-importing countries, such as Japan, to give agriculture a high priority. Many nations imported new agricultural technology that now has borne fruit.

The global surplus of food and feed grains is expected to surge to a 13-week supply this year; an eight-week supply would be ample. The U.S. has more than a one-year supply of wheat, enough for both exports and domestic consumption.

With farmers in dire financial trouble, the business of supplying them with new equipment is as dead as last year's cornfield. World-wide tractor output fell to 120,000 units last year from 230,000 in 1979. For larger equipment, the declines have been even sharper. Manufacturers produced 20,000 over-100-horsepower tractors last year, down from 80,000 in 1979.

"The downturn has been so dramatic that no one has done anything but cut back," says John Ruth, Massey-Ferguson's president. He says he doesn't know of any additions to industry capacity anywhere in the past five years. Because of high costs, some U.S. facilities were among the first to close, with part of their production moving to existing foreign plants.

Mr. Ruth sees further cutbacks in capacity needed for anyone to make a profit. But for now, companies are playing an industrywide game of chicken. No one wants

In construction equipment, too, demand is down, but, surprisingly, capacity is still rising.

In the late 1970s, construction-equipment sales surged, and plants were operating at close to capacity even though Japan was working hard to build a construction-equipment industry. But from 1980 to 1983, demand plunged 70%, beaten down by reduced demand for coal as well as a decline in world-wide construction activity. Construction was hurt in part by declining oil profits and international-debt problems.

Now, demand has recovered a bit, but the industry is still running only at about 60% of capacity. Nevertheless, some countries are planning to expand even more. Industry analysts expect South Korea soon to begin an assault on the market. "Korea is a big emerging threat," says Frank Manfredi, the publisher of Machinery Outlook, an industry newsletter. "Everyone is expecting them to come into the market like gangbusters." Other countries that have added capacity in construction equipment are China and Italy.

"It's ironic that even though sales have been lousy, there's more capacity in the industry than there was five years ago," says Mitchell Quainn, a securities analyst at Wertheim Shroder & Co. "It's almost as if every country wants to have its own bulldozer manufacturer."

Textiles

Seeking crucial foreign exchange and jobs for surging populations, many developing nations are producing textiles and apparel at rates far above domestic demand. Building a textile industry "is the first thing that a developing nation does" as it moves toward industrialization, says Ron Levine, a Commerce Department official. He notes the abundance of raw materials and such countries' cheap labor.

Cheap labor is at the heart of the overcapacity problem cited by the U.S. industry. For six years, foreign producers have flooded the American market with goods, principally apparel fabrics and finished garments, and forced the domestic industry to shrink dramatically to survive.

Arriving in the U.S. last year were some 12.7 billion square yards of imports, 17% more than in 1985 and more than double the 1980 level. "Imports have achieved a successively increasing share of the [U.S.] market," says Donald R. Hughes, the chief financial officer at Burlington Industries, the nation's largest publicly held textile concern. In six years, imports have taken 55% of the total market, up from about 25% in 1980, he says.

"Historically, the level of increase in [U.S.] demand has been about 1% annually. Yet imports have been growing at a rate of 15%," he adds.

Domestic textile leaders blame the Reagan administration's trade policies for the surge in imports. And the drop in the dollar hasn't slowed the imports because most of them come from Asian nations with currencies pegged to the dollar.

The glut of imports has forced the domestic industry to reassess its basic structure and make sweeping changes. Domestic companies have closed dozens of plants—at a cost of about 700,000 jobs—and installed high-tech equipment designed to make mills more efficient and versatile. They also are emphasizing marketing and customer services, and some analysts see domestic retailers and garment makers gradually shifting back to buying from U.S. sources because of improved quality and quicker deliveries.

Chemicals

Chemical companies have scrapped scores of plants in recent years, spurring a long-awaited growth in plant-capacity use. Last year, chemical-plant use rates rose to an estimated 80.5% from 66% five years ago, according to the Chemical Manufacturers Association. The trade group expects plant use to reach 82.3% this year, Myron Foveaux, a spokesman, says.

The wave of plant closures reflects retrenchment from the industry's building boom in the mid-1970s. The recessions of the early 1980s convinced many chemical producers that the industry was awash in capacity, says Sano Shimoda, an analyst at Anantha Raman & Co., of Parsippany, N.J. Total U.S. chemical-plant capacity fell 3% between 1984 and 1966, he estimates.

The retrenchments were especially successful in plastics. During the 1960s and 1970s, plastics appeared to be one of the most promising growth industries. Plastics were replacing glass, paper, metals and other materials in applications ranging from plumbing to auto parts. Chemical manufacturers, oil and gas producers, and tire makers built plastics plants. Few old facilities were shut down.

Demand did grow, but not as fast as forecast. By 1980, there was overcapacity for many plastics, and prices plunged. Some companies pulled out of the business, and most others halted plant construction. In both Europe and North America, some old plants were closed. Gradually, the cutbacks and rising consumption brought supply and demand for some common resins in better balance.

Polyvinyl chloride illustrates the trend. U.S. capacity more than doubled between 1965 and 1974, dipped briefly during the 1973-75 recession and then doubled again. By the end of 1953, U.S. capacity was about 6.5 billion pounds a year, up from two billion in 1965. But although PVC has grown rapidly in pipe, siding and other construction applications, no major plant has been built since 1953, and U.S. PVC plants are running at close to 90% of capacity. In Europe, there still is some overcapacity, but some plant closings are planned. Worldwide capacity is likely to be tight for five years or so, according to Richard Roman, the manager of marketing research for the Geon Vinyl division of B.F. Goodrich.

Among the large-volume resins, polystyrene, used for many inexpensive molded products, now is in the tightest supply. Dow Chemical, a major producer, is running its polystyrene plants at about 91% of capacity, "right at the ragged edge of what we can do," a spokesman says.

In contrast, the fertilizer industry, suffering along with the farmers, is still in trouble. Between 1984 and 1986, capacity reductions reached 7%, but plant-use rates are still only 74%, Mr. Shimoda says.

By spurring demand for chemicals, lower oil prices have helped U.S. chemical producers increase plant use, Mr. Foveaux says. Cheaper oil, along with chemical producers' sweeping cutbacks in personnel and productivity gains stemming from development of improved chemical catalysts, has enabled the companies to reduce plant break-even points to 70% from 75% five years ago, Mr. Foveaux says. "It's still not ringing bells, but, as a whole, the industry is much better off," he adds.

Although some small specialty chemical plants are likely to be built soon, both Messrs. Foveaux and Shimoda expect U.S. basic-chemical production to shrink further. "Profitability is improving, but people are still very hesitant to build," Mr. Shimoda says.

The Outlook

In view of the problems, what is the outlook for American companies struggling in industries with global overcapacity?

Noting that "manufacturers have sharply reduced operating costs and restructured their industries," Alan Greenspan, a New York consultant, says, "We still have problems because the real cost of capital is too high. That slows the replacement of obsolete capacity." He adds:

"Funds are diverted away from research, away from long-term projects. The emphasis is on high-tech investments that pay off fast—and become obsolete quickly. There's no incentive for the sort of investments that would bring back the Rust Belt. Economic policy really does matter."

Saying that "a variety of industries still have huge readjustment problems . . . associated with the excess capacity," Karl Brunner of the University of Rochester adds:

"If we want to be competitive in the world, we have to stand back and let the adjustments take place. We can't protect these industries from change, any more than we protected the Pony Express riders of a century ago. We have to improve our use of resources and our productivity.

"Sure, it would help if we could distribute more products overseas to people who need them. But we aren't going to solve the U.S. auto industry's problems by selling more cars to Africa in the next decade. We have to begin with adjustments here at home. We have to mitigate the hardships for the people caught in these adjustments, but we can't let that stand in the way of the adjustments being made."

The Club of Rome's Notorious Forecast

By a Wall Street Journal *Staff Reporter*

Amid the current global glut of industrial capacity, the gloomy, limits-to-growth forecasts put out by the Club of Rome experts in the early 1970s are widely viewed as being off by 180 degrees.

Perhaps a fairer estimate would be that they were off only 120 degrees.

For one thing, their most explicit forecasts concerned the year 2100 and not the 1980s. On the other hand, the forecasts were presented in a way that strongly implied that the problems were imminent.

Moreover, the analysts weren't discussing industrial capacity per se. "The Club of Rome people were talking about physical quantities. There was so much iron, so much oil in the world, and at the rates of consumption then existing, the world's resources would be used up," explains Alan Greenspan, a New York economic consultant. But he adds: "What they didn't anticipate was our capacity for downsizing. When oil prices rose in the 1970s, we showed we could build smaller cars that used less en-

Donald Ratajczak, the head forecaster at Georgia State University, agrees. Citing energy as "the most dramatic example," he says the price-induced drop in consumption goes far beyond cars. "In 1972," he says, "it cost us almost 1% growth in energy consumption to create 1% growth in GNP [gross national product]. Now, we can create a 1% growth in GNP with almost no incremental growth in energy consumption." Plastics or cheaper metals have been substituted for copper in many applications, silver usage in photographic film has been cut dramatically, and so on.

However, Jay W. Forrester, an economist at the Massachusetts Institute of Technology and an early participant in the Club of Rome, disagrees that the current overcapacity negates the study's warning of "limits to growth." The study, he says, involved "a much longer-term view, that industrialization was pushing up against the environment, as manifested today by such increasing problems as industrial-waste disposal and falling water tables." He

DCMA
DRY COLOR MANUFACTURERS' ASSOCIATION

Representing the Color Pigments Industry

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March 23, 1987

The Honorable Lloyd Bentsen
Chairman
Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

The Dry Color Manufacturers' Association (DCMA) very much appreciates this opportunity to support the comments of the Automotive Parts and Accessories Association (APAA) concerning the need for changes in the procedures of the Foreign-Trade Zones Board. DCMA is an industry trade association representing small, medium and large pigment color manufacturers throughout the United States and Canada, accounting for approximately 95 percent of the production of color pigments in this country. Foreign pigment manufacturers with sales in the United States and Canada and suppliers of intermediates to the pigments industry are also members of the Association.

DCMA fully supports APAA's emphasis on the need to prevent the use of foreign-trade zones and subzones for unfair competitive advantage in the domestic U.S. market. We urge congressional consideration of legislation that would require the Foreign-Trade Zones Board to hold a hearing on the record under the provisions of the Administrative Procedure Act and to find substantial evidence of a net benefit to U.S. employment before foreign goods used in manufacturing activities within a foreign-trade zone or subzone would be exempt from U.S. customs duties. Zone and subzone activities that are exclusively for export would be exempt from these requirements.

Foreign-trade zones and subzones are an exception to the customs duties that are mandated by the Congress. Manufacturers authorized to operate subzones may import foreign raw materials and pay duties only when the finished article leaves the subzone. Those articles exported from the U.S. are exempt from all duties. Those articles that enter the U.S. are subject only to the duties applicable to the finished article, rather than those applicable to the raw materials, which may be dutiable at a higher rate. Alternatively, foreign merchandise granted privileged status is dutiable at the rates applicable to its condition on entering the subzone.

Subzone activities have grown enormously in recent years. According to a recent General Accounting Office report, the value of the products leaving subzones increased from $47 million to $2.4 billion between 1973 and 1982. Although it was originally expected that subzones would be used primarily for export purposes, the General Accounting Office also found that 89 percent of subzone products are destined for the U.S. market and that only 11 percent are exported.

By encouraging U.S. manufacturers to produce for export, subzones can play a valuable role in expanding America's foreign trade. However, subzones can also provide unfair competitive advantages where manufacturers who use subzones to reduce the cost of their raw materials compete in the U.S. market with manufacturers without subzones who must pay higher U.S. prices or full customs duties on their raw materials.

Because of the potential danger to equal competition from foreign-trade subzones, existing law and practice require applicants to demonstrate to the Foreign-Trade Zones Board that the establishment of a subzone will result in public benefits that outweigh any damage to U.S. domestic industries. These public benefits are usually measured in terms of the net effect on national employment. The legislation that DCMA is proposing would ensure that this public interest standard is in fact applied.

DCMA urges that the Foreign-Trade Zones Act be amended to require that, on the request of any person, the Foreign-Trade Zones Board must hold a hearing on the record in accordance with Sections 556 and 557 of the Administrative Procedure Act and find substantial evidence of a net benefit to national employment before establishing any new foreign-trade zone or subzone or making any future grant of subzone status that would result in the exemption of foreign goods used in manufacturing activities within the zone or subzone from U.S. customs duties. This requirement would not apply where zone or subzone manufacturing activities were exclusively for export. Such a requirement would ensure that full consideration is given to all available evidence of the likely effects of a zone or subzone on national employment. It would allow all interested parties a full opportunity to provide information on likely employment effects and to challenge all of the information provided by applicants.

In amending the Foreign-Trade Zones Act in 1950 to allow manufacturing activities in foreign-trade zones, it was not the intent of the Congress that zones and subzones should be used to favor one U.S. manufacturer competing in the domestic marketplace over another. Nor was it the intent of the Congress that one region of the county should be favored over another. The legislation that DCMA is now proposing would not eliminate all manufacturing activities within foreign-trade zones, as some critics would wish. Instead, it would preserve subzone benefits for export activities and for those other activities that provide a net benefit to national employment, while preventing the use of subzone benefits by one U.S. company, industry or region to displace a greater number of jobs in other U.S. companies, industries or regions. The legislation would ensure that the customs duties mandated by the Congress were set aside by the Executive Branch only where there was substantial evidence that there would be no resulting loss of jobs to American industries.

The Dry Color Manufacturers' Association very much appreciates your consideration of our comments and would be pleased to respond to requests for any additional information.

Respectfully submitted,

J. Lawrence Robinson
Executive Vice President

STATEMENT OF
OCCIDENTAL CHEMICAL CORPORATION
BEFORE THE SENATE FINANCE COMMITTEE
ON THE STATE TRADING ENTERPRISE
PROVISIONS OF S. 490

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April 10, 1987

STATEMENT OF
OCCIDENTAL CHEMICAL CORPORATION

Occidental Chemical Corporation appreciates the opportunity to submit this statement to the Finance Committee on the provisions of the Senate's omnibus trade bill (S. 490, sections 107 and 305(e)) dealing with so-called "mercantilist" trade practices by foreign state trading enterprises. Occidental has several basic concerns about these provisions and thus opposes their inclusion in any trade legislation acted on by Congress this session.

A "state trading enterprise" is defined in S. 490 to include two types of entities. First, the term includes an agency or instrumentality of a foreign country that purchases (other than for its own use) or sells goods or services in international trade. Second, it also includes a "business firm" that (a) is substantially owned or controlled by a foreign country or instrumentality, (b) "is granted (formally or informally) any special or exclusive privilege" by that foreign country, and (c) purchases (other than for the use of the foreign country) or sells in international trade.

The bill defines certain foreign government actions as unfair "mercantilist" practices against which the U.S. is authorized to respond. These practices include government actions that enable a state trading enterprise to compete with U.S. firms in international trade, or to make purchases or sales in international trade, on a basis other than "commercial considerations." They also include a foreign government's exercise of its authority or power to assist a state trading enterprise to compete with U.S. firms or make purchases or sales in international trade on noncommercial terms. The bill gives examples of "commercial considerations," such as price, quality, availability, marketability, and transportation. Finally, also within the scope of the bill are foreign government practices that fail to give U.S. firms adequate opportunity to compete for purchases to or sales from state trading enterprises.

The bill responds to such practices by defining them as "unjustifiable" practices under section 301 of the Trade Act of 1974, 19 U.S.C. 2411. Under section 301, the President, after an investigation and consultations with the foreign government by the U.S. Trade Representative, is authorized to retaliate against unjustifiable practices. Such retaliation may take a variety of forms, including duties, quotas, withdrawal of benefits under trade agreements, and the like. In fact, under other provisions of the Senate's trade bill (S. 490, section 304), section 301 would become more severe in effect by eliminating the President's discretion and compelling, rather than merely authorizing, retaliation where unjustifiable acts are found.

S. 490 authorizes U.S. response to state trading activities in yet another way. Before a foreign country accedes to a multilateral trade agreement to which the United States is a party, the President must determine (1) whether state trading enterprises account for a "significant share" of either exports from the country or goods subject to import competition in the country, and (2) whether the state trading enterprises "unduly burden, restrict, or adversely affect," the United States' economy or foreign trade (adopting language from section 301). If so, then the President must reserve extension of the trade agreement between the United States and the foreign country. Extension is permitted only if Congress passes approving legislation or if the foreign country agrees that its state trading enterprises will act in conformity with the standards set out in the bill.

The bill's sponsors state that these provisions are intended to implement Article XVII of the General Agreement on Tariffs and Trade (GATT), which covers state trading enterprises. Indeed, the bill incorporates some of the GATT language verbatim. The scope of the legislation, however, is far broader than the GATT article it is intended to implement, and it thus gives rise to several substantial concerns:

- o The legislation is unnecessary. All the activities the provision would label as unjustifiable practices already fall within the scope of section 301. Moreover, to some extent the section 301 remedy provided in the bill is also duplicative of existing remedies under the countervailing duty law.

- o Although the bill purports to implement Article XVII of the GATT, it actually is far broader in effect, by compelling "national" as well as "most-favored-nation" treatment by state trading enterprises.

- o Use of the "constructed value" test in determining whether a state trading enterprise's sales are consistent with "commercial considerations" is totally inappropriate. The "constructed value" methodology compels very specific calculations that fail to account for the market-oriented considerations clearly authorized both by the GATT and in S. 490 itself. Moreover, the USTR's office is not properly equipped to handle the complex, detailed calculations and fact analyses necessary under the constructed value test.

- The bill is unacceptably overbroad due to its application to private "business firms" that are "granted (formally or informally) any special or exclusive privilege" by the foreign government. The "privilege" language remains undefined, and although it was lifted from the GATT, it is impermissibly vague when used in specific legislation. As a result, a whole range of companies may be found to be covered by the bill because they receive some form of government "privilege."
- The state trading enterprise provisions are ill-advised in their application to non-market-economy as well as market-economy countries. GATT Article XVII was intended to apply only to the latter. Furthermore, application of a commercial considerations requirement -- especially with a constructed value test -- will be arbitrary and meaningless in the case of NME's.
- The new round of multilateral GATT negotiations specifically raises Article XVII as one area to be considered. Unilateral action by the United States at this time would be counterproductive and may well result in a clash with the conclusions of the GATT's negotiations.

These problems will be discussed in turn.

A. State Trading Enterprise Legislation Is Unnecessary

Section 301 as presently written already identifies certain government activities as either unjustifiable, unreasonable, or discriminatory practices, to which the

President is authorized to respond. "Unjustifiable" practices are those that violate or are inconsistent with the United States' international legal rights. "Unreasonable" practices, although not necessarily in violation of U.S. legal rights, are "unfair or inequitable." This includes practices that deny fair and equitable market opportunities or opportunities to establish an enterprise in a foreign country. "Discriminatory" practices include those that deny national or most-favored-nation treatment for U.S. goods or services. In addition, section 301 authorizes the President "to enforce the rights of the United States under any trade agreement," and to respond to foreign practices that are "inconsistent with the provisions of, or otherwise den[y] benefits to the United States under, any trade agreement . . . ."

These provisions clearly cover the types of practices that are the focus of the state trading enterprise sections of S. 490. In fact, as noted by Alan Holmer, General Counsel of the Office of the U.S. Trade Representative, in testimony before the Trade Subcommittee of this Committee last year, the USTR has already invoked section 301 on several occasions to respond to state trading practices. The most obvious manner in which section 301 applies to state trading activities is that a foreign government's action in violation of a GATT article (such as Article XVII) is "inconsistent with the provisions of . . . [a] trade agreement," to which the President may respond. If the foreign practices deny benefits to, or infringe on the rights of, the United States, the President may likewise take action; in addition, such GATT violations may also violate U.S. international legal rights, which is considered an unjustifiable practice under section 301.

Moreover, the bill's specific concern with the failure to provide U.S. firms adequate opportunities to sell to state trading enterprises may already be within the scope of "discriminatory" practices under section 301. Likewise, the definition of "unreasonable" practices, which includes the denial of fair and equitable market opportunities, covers the bill's concerns with purchases or sales by state trading enterprises that disfavor U.S. firms. Finally, section 301 also applies to foreign government practices that have an adverse impact on U.S. exports to third country markets.

Because the bill's concerns are already covered by section 301, the addition of new language specifically dealing with state trading enterprises is unnecessary and redundant. Furthermore, the bill responds, in large part, to foreign government actions that enable a state trading enterprise to compete in international trade on noncommercial terms. To the extent they lead to exports to the United States, however, these actions are already covered as subsidies under the U.S. countervailing duty law. Nothing is gained by the duplicative provisions of S. 490, which authorize responses to the same foreign government activities through the less-structured remedy provided in section 301. Indeed, as a matter of practice, the USTR routinely defers to the Department of Commerce and the International Trade Commission when it appears that a section 301 petition raises subsidy issues.

B. The Bill Is Substantially Broader Than GATT Article XVII in Requiring National Treatment by State Trading Enterprises

Paragraph 1(a) of GATT Article XVII provides that state trading enterprises shall, "in [their] purchases or sales involving either imports or exports, act in a manner consistent with the general principles of nondiscriminatory treatment prescribed in this Agreement . . . ." The negotiating history of this provision makes clear that it was intended to mandate "most-favored-nation" treatment of purchases and sales by state trading enterprises. A state trading enterprise must treat purchasers or sellers from different foreign nations equally.

The requirement of paragraph 1(a), however, does not extend to "national" treatment. That is, although the state trading enterprise must treat all foreign parties equally, "it is entitled to discriminate between domestic and foreign products in its purchases or sales . . . ." J. Jackson, World Trade and the Law of GATT § 14.5 at 347 (1969). The GATT provision that does mandate national treatment (Article III) is limited in its application only to internal taxation and regulation of goods once they have been imported; it is not meant to apply to purchases and sales in international trade. Jackson, supra, § 14.3 at 338.

Contrary to this limitation on the application of Article XVII, the state trading enterprise provisions of S. 490 have the effect of mandating national as well as most-favored-nation treatment. The bill does this by way of its definition of "commercial considerations," on the basis of which state trading enterprises are required to compete with U.S. firms and make purchases or sales in international trade. "Commercial considerations" are determined either on the basis of arm's length transactions by parties not state trading enterprises, or, if there is insufficient evidence of such transactions, the constructed value of the merchandise. These formulations, in effect, set up a single, uniform benchmark against which the state trading enterprise's purchases and sales are compared. No consideration of differential treatment for domestic and foreign parties is authorized.

In compelling national as well as most-favored-nation treatment, S. 490 takes a substantial step beyond the GATT in restricting state trading enterprise activities. Furthermore, in doing so, the bill seriously intrudes in the domestic activities of foreign countries. Governments, of course, engage in a variety of programs to benefit domestic industries, and some do so through government-controlled entities that would be labeled state trading enterprises under the bill. The GATT recognizes the validity of such government programs, and does not automatically condemn government actions that have differential impact on domestic and foreign parties. Under S. 490 this basic distinction would be threatened, however, in cases involving state trading enterprises.

The United States government itself engages in programs that benefit domestic interests in ways that would fall within the scope of S. 490. One example is when its farm agencies purchase grain from domestic producers at special rates. The provisions of S. 490, if applied to the United States (*e.g.*, through the enactment of foreign mirror legislation), could lead to the imposition of penalties against such U.S. government programs.

C. The Constructed Value Test Is Inappropriate for Determining Whether a State Trading Enterprise's Activities Are Consistent with Commercial Considerations

The bill provides that if there are insufficient arm's length transactions by private parties to compare with the state trading enterprise's actions, commercial considerations must instead be measured by the constructed value test. This test, which is imported from the antidumping law, 19 U.S.C. 1677b(e), mandates that the fair value of merchandise be determined by calculating its fully allocated cost of production, including a minimum percentage for overhead (10%), plus profit (8%).

Use of the antidumping standard is totally inappropriate for determining "commercial considerations" in the context of a section 301 action concerning state trading activities. First, use of the antidumping standard in the midst of a section 301 proceeding is ill-advised, because the USTR's office is not properly prepared to handle the complex, detailed numerical calculations and factual data analyses necessary under the constructed value test. Moreover, the bill provides no explanation of the relationship between the rigid method of determining commercial considerations under the constructed value test and the more flexible analysis apparently called for in the bill's provision listing general factors -- such as price, quantity, availability, and so forth -- to be used in making the same determination. Indeed, the two methods of determination are inherently contradictory, because the one takes no account of the market conditions the other demands.

Furthermore, the bill makes no clear connection between commercial considerations as valued under the constructed value test and the injury to be assessed or remedies to be applied. Presumably, the bill intends that sales by state trading enterprises to parties in nations other than the United States at prices lower than the constructed value would be treated as violations of section 301. The bill thus would leave state trading enterprises vulnerable to challenge whenever their sales prices are lower than the fully allocated cost of producing the merchandise plus an eight percent profit margin. This effectively requires state trading enterprises to satisfy a pricing standard private businesses often do not meet, for in regular market operations there are often circumstances in which prices do not cover fully allocated cost plus eight percent.

Such a rigid rule is also contrary to Article XVII, which provides that a state trading enterprise may charge "different prices for its sales of a product in different markets . . ., provided that such different prices are charged for commercial reasons, to meet conditions of supply and demand in export markets." Interpretive Note to GATT Article XVII, ¶ 1. In fact, the "commercial considerations" language was included in Article XVII and the Intepretive Note at the insistence of some of the GATT negotiators, to ensure that state trading enterprises retained the flexibility to vary their prices to meet differing market conditions. Jackson, supra, § 14.5 at 345-46. The bill, however, would use the language to precisely the opposite effect, by compelling not only pricing uniformity but also, under the constructed value test, uniformity at an artificially inflated level.

D. The Applicability of the Bill Is Impermissibly Broad Because of Its Failure to Define "Exclusive or Special Privilege"

The bill applies not only to foreign government instrumentalities but also to business firms substantially owned or controlled by a foreign government, which are granted an "exclusive or special privilege" by that government. The "privilege" language is taken verbatim from GATT Article XVII, and remains undefined in both the GATT and the bill. Although such broad language may be acceptable in a basic international document like the GATT, it is impermissibly vague when used, unexplained, in legislation. In fact, the "privilege" language is broader in the bill than in the GATT, because the latter includes a limiting provision in the Interpretive Note, which explains that certain government measures are not to be considered "privileges" covered by Article XVII.

The breadth of the "privilege" language in S. 490 would result in the inclusion of numerous government actions that may be seen as conferring benefits or privileges on their recipients -- such as tax breaks, the provision of services, or even subsidies. As a result, the bill could be stretched to cover the activities of a large number of foreign enterprises beyond the contemplation of Article XVII. For example, it is artificial to suggest that manufacturing companies subject to some government ownership or control -- such as steel companies in Western Europe or textile mills in China -- become trading enterprises covered by the bill merely through the receipt of a "privilege" from their governments. A more appropriate response would be to challenge the privilege directly, for example, as a subsidy under the countervailing duty law or as an unjustifiable, unreasonable or discriminatory practice under section 301. It is simply unnecessary and inappropriate to set up a parallel remedial scheme challenging the market behavior of the foreign companies solely because they receive such "privileges."

E. The Bill Is Ill-Advised in Its Applicability to Non-Market as Well as Market-Economy Countries

Article XVII of the GATT makes no mention of state trading enterprises in non-market-economy countries ("NME's"), and thus obviously makes no distinction between those entities and state trading enterprises in market-economy countries. The bill, adopting closely similar broad language, likewise fails to make any such distinction. In the years since the GATT was drafted, however, NME's have come to play a significant role in international trade. But because of the fundamentally different market conditions existing in NME's, the simplistic application to these countries of rules intended to govern market economies -- such as Article XVII -- is inappropriate. As one commentator has noted, "If Article XVII is at present the only special obligation imposed on state traders it must be realized . . . that it was not designed to cope with the somewhat different problem of states with a totally planned economy." G. Curzon, Multilateral Commercial Diplomacy 294 (1965).

Thus, it is all but meaningless to apply a "commercial considerations" test, such as that provided in S. 490, to the market activities of a state trading enterprise in a NME, and it is equally meaningless to attempt to quantify such commercial considerations through the use of a constructed value test. The difficulty in applying such measures to NME's is already well-recognized in the antidumping law, which uses a totally different methodology for determining foreign market value in cases involving NME's. To the extent that Congress wishes to respond to state trading activities by NME's as well as market-economy countries, the complex issues that arise in such an exercise require separate, careful consideration.

F. Legislation Implementing Article XVII Is Inappropriate at This Time Because the GATT Has Commenced Negotiations on That Article

The Uruguay Round of multilateral GATT negotiations explicitly raises Article XVII as one area to be reviewed and clarified. GATT Ministerial Session -- Background Notes at 16 (GATT/1395, Sept. 10, 1986). It is counterproductive for the United States, one of the participants in the Uruguay Round, unilaterally to interpret a GATT provision that will be subject to multilateral interpretation at the same time. And to do so could well result in clashes between the U.S. interpretation and that ultimately reached in the GATT negotiations. Far more sensible would be to await the resolution of the issues by the GATT, and then for the U.S. to enact legislation as needed to implement the multilateral agreement.

For the foregoing reasons, Occidental Chemical Corporation opposes the state trading enterprise provisions of S. 490 as unnecessary, overly-broad and GATT-incompatible.